AN INTRODUCTION

TO

WORLD ECONOMIC HISTORY

SINCE THE GREAT WAR

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By

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PREFACE

We are now reaching a generation of students who were not born when the Armistice of 1918 was signed. They find themselves living in a world whose economic conditions are generally represented to them by their elders as upset and abnormal, but have had no personal experience either of what was upset or of the upsetting. This book is an attempt to give such students, in the briefest possible form, some explanation of the economic damage caused by the Great War and of the subsequent progress towards recovery. The success of such an attempt depends on a wise selection and a correct emphasis, but in dealing with so large a field and with phenomena so intricate, so recent, and so interwoven, no author can feel much confidence in his own judgment. If the presentation was to be of any real help to the young student of to-day, I felt that some structural coherence had to be given to the narrative, some set of clues to the underlying drift of events. Since economic history must always be an account of efforts to use available resources in the most advantageous way possible to satisfy the material needs of mankind, it seemed to me permissible to take the legacy of economic maladjustment and the efforts—mistaken or beneficient—to correct it

as the clue of the post-war story. In addition, the legacy of debt, itself a cause of economic maladjustment, has proved sufficiently onerous to be considered entitled to especial emphasis, while, on the fringe of and beyond the strictly economic field, the tendency of mankind to lose faith in much that he had formerly trusted has had such deep-seated influence on events that some special reference to it was also needed.

The book commences, therefore, with the three war legacies of dislocation, debt, and distrust. At once we encounter our first danger: that the mere structure of the book may induce students to believe that all our present troubles are due to the War and that none of them can be traced to earlier origins. This, of course, is not so. There are, indeed, those who regard the War as a mere foretold episode in the collapse of capitalist civilisation. Others will agree with Sir Basil Blackett's statement that "the War itself was in some sense only a devastating explosion of forces which in the passage from the nineteenth to the twentieth centuries were being inexorably generated by the conflict between man's rapid intellectual and scientific advance and his slow moral and spiritual growth. The War hastened the tempo of the drama and intensified its bitterness and tragedy". Whether the view is correct or not that the War interrupted but did not radically change the trends previously evident, the student is warned not to be misled by the structure of this book into minimising the continuing force of pre-war tendencies.

It would, I think, meet with general acceptance that any narrative of post-war economic history should fall into two main sections: up to about 1926, and after 1929, with the Geneva World Economic Conference in 1927 as a convenient and significant marking point. I feel less certain that the chapter headings will pass criticism; it may be they stress too much the monetary aspect—though Professor Cassel claims that "after the War, management of the currency has come into the foreground as the overwhelmingly predominant factor in the world economy"—but some sort of scaffolding for the erection of the narrative is essential if the story is not to degenerate into a chronological but indigestible jumble of unrelated facts. Something, at least, will have been accomplished if the student is led to appreciate that the scaffolding is not altogether satisfactory.

What other scaffoldings were available? One might have written the story as an account (1) of the changing standards of living and those profound changes in the structure of demand to which Professor Ohlin draws attention;[1] (2) of the growth of State interference with industry; (3) of the improvements in invention and technique; (4) of the developments of the social services; (5) of the growing rigidities in the economic organism; (6) of the growth of economic nationalism. The movements of the price level seem to me to reflect the past, and influence the future, general progress or

[1] *The Courses and Phases of the World Economic Depression*, Chapter I, B.

decline of world economic activity less obscurely than any other single guide one might have chosen. For example, the fall in prices after 1929, whether it be regarded as the result of previous, or the cause of later, economic developments, appears to me to have had a more really world-wide significance than any other single economic phenomenon. The only defence for choosing and stressing a single phenomenon is that it makes the narrative easier to follow and does provide a tentative clue to the drift of events. Even an outline of world economic history since the War would deal with the six phenomena listed above and many others and would fit their stories in at the proper places and times—a complicated bit of mosaic work—but my intention was not to write such an outline but rather an introduction, something a student might usefully read before beginning a serious study of post-war economic history in all its wide ramifications.

To deal adequately with the interaction of economic and political developments would have defeated my intention to keep this book as brief and compact as possible. An outline of world political history since the War might very usefully be read in connection with this book, and there are such outlines available. The thoughtful student will carry this interaction in mind.

It is not possible to acknowledge specifically my indebtedness to the very many sources of information from which I must have drawn, but the World Economic Surveys of the League of Nations have

been particularly helpful for the period since they started, and I should like to express my thanks to the members of my post-graduate class at McGill University who went over the ground with me and helped me with their contributions and their criticism. Dr. Stephen Leacock, Miss N. E. McIver, Professor E. R. Adair, and Professor J. T. Culliton were good enough to read the manuscript but bear no responsibility for the result.

CHAPTER I

THE LEGACY OF MALADJUSTMENT

Fully to appreciate the magnitude of the economic dislocation caused by the Great War of 1914–18 it is necessary to get some idea of what was dislocated, some mental picture of that approach to economic equilibrium which was induced by the continuous striving of all the agents of production to place their services where their reward would be greatest.

The workers were always endeavouring to get into the occupations which for each of them offered the highest net advantages of employment. It is true they encountered many obstacles. Many occupations which they might have chosen were closed to them by their inability to pay for a more or less costly period of training and apprenticeship, and into other occupations, which they were qualified and competent to take up, entry might have been barred by restrictions imposed by some authority or other, whether it were a Trade Union, a professional controlling body ostensibly maintaining a high standard of qualification, or the fault of restrictive policies adopted by those directing an industry who, having power through a combine, reduced output below what was economically

justifiable and so required fewer workers. Nevertheless, admitting these and possibly other obstacles such as those caused by racial or social prejudices, it remains true that any man who had become aware of a better job available for him, would have taken it, and any man discontented with his job would have endeavoured to qualify his sons for something different. The mobility of labour was far from perfect within any country and, as between countries, emigration was meeting increasing difficulties. Yet, the longer the period of steady economic progress, the more readily did the whole labour force sort itself out amongst the various occupations to the best advantage under the existing conditions of mobility. Constant changes and shiftings were always going on at the margins but, excepting cases where skilled workers found their particular skill no longer in demand, the shifts were advantageous.

In the same way, those who had capital to lend and those who wished to use it were alike endeavouring to place or use it where the reward would be highest in the long run. Whenever restrictions were not imposed either by legal authority or economic power, enterprise chose the opportunities which appeared most promising and capital flowed in that direction. Here again, changes, adjustment, and shifting were constantly at work; demand might change as the preferences of consumers altered—less porridge and more orange juice—or as Government policies of taxation or tariffs shifted effective demand from group to group; the conditions of

supply might alter through fluctuating harvests, by the gradual exhaustion or new discovery of raw material supplies, by the invention of better technical processes or by the economies of a larger scale production or distribution; but always the drive was to get out of the poorer and into the richer fields. The less violent the changes in demand and supply, the stabler became the economic conditions, and the more nearly the distribution of capital and enterprise approached to the optimum under the social arrangements permitted. Loan capital was more mobile than fixed capital, just as the boy entering industry has a wider choice than an oldish man with set habits and an acquired specialised skill, but even with fixed capital the rate of scrapping of obsolescent plant was becoming faster.

So, too, with land was there the slower but continuous tendency to use it in the most profitable way; arable land might revert to pasture, sheep runs be abandoned for the sake of the shooting rights, agricultural land become developed as building sites.

Very possibly, the continuous endeavours of all the productive agencies to move into the most remunerative employments resembled less the placid progress of contented cows moving towards better grazing than the hectic scrambling of ants up a slope of slipping sand grains, but there seems little reason to doubt that, for at least several decades before the outbreak of war in 1914 and in spite of the upsets caused by the fickleness of taste, by

inventions and discoveries, by changes in taxation, and by the depreciation of gold since 1896, the sifting and shifting process had succeeded in distributing the various agencies of production in a reasonable approximation to the best locations available under the existing social and political arrangements. Certainly it had succeeded far better than any attempt at authoritarian planning could have done, or ever could do without a very protracted period of trial and error, dissatisfaction, and despotic interference with personal liberty.

Emphasis is placed on this shifting and sifting process not merely to show that every man endeavoured to use his resources in the most profitable way; that, indeed, has been recognised as a working hypothesis ever since Adam Smith wrote of the natural desire of every man to better his conditions. The point is, rather, that the process greatly facilitated the exchange of goods and services, and it is so important to realise this that it is better to incur the risk of wearying the reader than to pass on without its full appreciation.

When a commodity is placed on the market at a certain price, say 100 caps at one dollar each, the value is represented by the costs paid out together with the profit retained. If \$90 were paid to 90 people who contributed their work or their property (e.g. raw materials) or the use of it (e.g. capital or land), and \$10 were kept by the owners, the former could purchase 90 caps and the latter keep and use the remaining 10. There is no lack of purchasing

power—whatever one may think of the equitableness of its distribution—and similarly with other products. The difficulty arises that neither the receivers of the income nor the profit-takers may want to consume these quantities in just that amount. They may, and as a matter of fact always do, prefer to spend their money on other things. Presumably, however, other people do want to buy caps or it would have been a business mistake to produce so many of them, a mistake which time would correct. Hence there has to be an exchange of goods, masked no doubt by the use of money, but essentially an exchange of goods, and this exchange will only take place if the terms are regarded as fair by both sides. Consider the case of a worker A who gets $1 and could buy one of the caps but wishes to buy something else. If the article he desires is on the market at a price which seems fair and reasonable to him, he will buy it, and the reasonable price will be such that will afford an equal dollar in wages to an equally efficient man B, who himself is willing to buy, either directly or by multilateral exchanges, the article A helped to produce. Now, A and B do tend to get equal wages through the shifting process, for if B were paid less than an equally efficient man A gets in cap making, the tendency is for him to leave his job and try to get into A's trade, thereby forcing his late employer to raise wages and enabling the cap makers to reduce wages until equality of reward is reached. It is no answer to this to say that one man shifting would make no difference. If 100,000

men shifted, the wage rates would change; if a smaller number shifted, the change certainly would not be so great, but, however small a number shifted, the tendency of the rates to change would exist.

The tendency, therefore, is towards equi-marginal returns; by which is meant that every industry tends to get pushed so far that equally efficient units of labour get paid the same in all occupations and therefore can buy each other's products at a price which should be satisfactory to all. There is no blocking of the exchange channels; the goods produced are sold and productive activity continues. The same reasoning explains the tendency to equi-marginal returns to those who assume the risks of business enterprise or provide the capital or land.[1]

It can be conceded that there is ample room for disagreement as to the strength of the tendency to equi-marginal returns, as to the amplitude and force of the obstacles it has to encounter, and as to that rate of change in the basic factors of demand and supply which seems indefinitely to postpone the attainment of an equilibrium

[1] Expressed more simply, but less precisely, the argument is that, if cap-makers are paid too little, they cannot buy enough of the products of other workers, while, if the cap-makers are paid too much, other workers cannot buy enough caps. There is, therefore, a proper wage, neither too high nor too low, which will enable full exchange to take place. There has to be a proper wage not only for the cap-makers but for all workers. Since wages are only one element in cost, the remaining elements must also be getting a "proper" reward in the same sense, if productive activity is to continue without dislocation.

which under static conditions one might hope to achieve.

Indeed, the very conception of equally efficient units of labour may seem far-fetched. How can one compare the efficiency of two men working at entirely different jobs? Jobs, however, can be conceived as in a series in which any one job does not differ materially, in its demands on skill and energy, from the jobs on either side, and the shifting process must be envisaged not as a skipping from one end of the series to the other but as a jostling repercussion running down, or, not impossibly, up, the line until absorbed. It is, of course, a process which takes time and, before it is finished, subsequent disturbances may arise. There is no reason to believe that under favourable circumstances the tendency to equi-marginal returns will not make good headway, any more than one need suppose that the sea, because it is always in movement and sometimes rough, can never become calm.

It may be simpler to try and explain the idea of economic equilibrium in looser terms. Everyone would admit that it is possible to produce a certain class of goods, or provide a certain service, in excess, to have too much of it, and that it is also possible not to have enough. The conclusion, therefore, must be that there is a certain quantity which, under existing circumstances, would be the correct quantity. The price which, relative to the effective demand, will enable this correct quantity to be all marketed, may be called the correct price at the time. But, though we always think of goods

as sold, and services as rendered, for money, they are in reality exchanged for other goods and services through the medium of money transactions. We really live in a system of disguised barter. The price, therefore, needs to be considered not as a price in money but as a price in terms of other goods and services. It follows, therefore, that, if all the goods and services are coming on to the market in just the right amounts relative to demand, their value-relationships—or prices in terms of each other—will be so correct that they will permit of all the necessary exchanges; everything produced will find a market. It is such a state of perfect adjustment of supply and demand that is meant by economic equilibrium. Nor need there be any unemployment of labour and capital under conditions of economic equilibrium, unless those who could offer them are in a position to regard the remuneration available as unworthy of their efforts, or unless the man or machine is really unemployable or worthless as an agent of production. When such equilibrium is lacking, the endeavour to restore it must take the form of increasing production here and decreasing it there, a shifting of capital and labour and the uses of land from one activity to another, though it has to be always remembered that neither human preferences nor human inventiveness and skill remain constant; we live in a dynamic and not a static world.

When a period of relatively stable economic conditions has given a fair opportunity for the shifting process to achieve its best results, there

will be no complaints of general over-production, of a lack of purchasing power, or of abnormal unemployment. Such complaints arise in times of an economic maladjustment so serious that the shifting process can neither quickly provide the cure nor can even operate at its usual rate. When, for example, many industries find themselves suddenly with a large surplus capacity to produce, it may be true that the reduced prices at which they are obliged to offer their products ought to stimulate the production of other goods, since the profitability of other enterprises will be increased, not in money income but in real purchasing power. However, if those responsible for the conduct of these other enterprises do not in fact go in for this economically justifiable expansion, either because they always calculate in money units and never in the real value of money or because they are daunted by the general pessimism caused by the many industries in difficulties, something in the nature of a temporary deadlock may ensue. The business expansion of the industries not over-developed would, had it happened, have brought prosperity back to the industries in trouble, both by increasing the value of the money the latter do make and by making feasible a reduction in their costs through a cut in wages made possible, in theory at least, by the reduction in the cost of living as prices fall with the increasing supply. If this expansion does not take place, adjustment can only be made by the weeding out of the weaker over-developed concerns through bankruptcy or by

some plan of industrial control which will keep all such concerns going at a lower output and higher prices, a method full of threats to the future economic welfare of the nation. Until such adjustment takes place, the over-production in the industries affected is so concentrated and obvious and the opportunities for the justifiable expansion of others is so diffuse and obscure that the complaint is made of general over-production in spite of the economists' denial of the possibility of any such thing.

The lack of general purchasing power is another economic fallacy. Of course, if one or more industries are producing more than can be sold at the market prices demanded, there is a lack of purchasing power for the surplus. The remedy is to reduce the output and bring demand, supply and price back into equilibrium. All industries, however, cannot be over-producing at the same time, since the aggregate costs of production are the same thing as the aggregate income, and the latter would always suffice to purchase the entire output and would do so if productive effort is properly distributed among the various enterprises. An appearance of a lack of general purchasing power may arise if the public, through lack of confidence, commence hoarding, or if the central banking authorities institute a deflationary policy. In either case, the appearance will pass away as costs and prices readjust themselves to a lower level, though the process will be spasmodic in action and troublesome in its discrete repercussions.

Abnormal unemployment is always the result of economic maladjustment. It increases as the need for shifting increases and as the obstacles to shifting become more formidable. The only case where economic maladjustment is not the sole cause of abnormal unemployment would appear to be a considerable increase in the number of workers of the lowest grade of unskilled labour who can neither shift up nor down and whose services might not be fully wanted at any rate of wages which society was prepared to tolerate.

It would be absurd to picture the pre-war economic conditions as perfect, but within the given social and political framework there was in general sufficient elasticity of adjustment to ensure that the vast majority of things produced would be sold at prices covering their costs of production, that the vast majority of people who sought employment would find work of some kind, and that nearly all people would be able to continue to buy the things they were accustomed to purchase. This result was the outcome of a long period during which the shifting and sifting process was able to keep pace with, or even gain on, the rate of change in demand and supply conditions. There was a degree of elasticity and adjustment which favoured economic stability, and it was this stability that the War shattered.

It is true that there were already growing threats to economic stability even before the War upset so much. One such threat was the increasing rigidities of the economic structure, a kind of economic

arthritis. Standard wages and standard prices were maintained against the impact of economic forces. In both cases the maintenance was possible by the economic or political power of large groups; a strong Trade Union maintaining a standard rate of wages, or a powerful Combine agreeing on a standard price. In both cases the action was taken in the immediate interests of the group and without adequate consideration of the ultimate result of such policies on the activity of the shifting and sifting process upon which the general welfare of the whole community depended. Furthermore, for many years there had been a tendency to concentration in industrial control, to amalgamation of interests. The driving force behind this was the greater economy of large-scale production, direction, and distribution. The two chief reasons why large-scale enterprise became possible and profitable were (1) technical developments making the use of elaborate and expensive machinery highly profitable provided that the output could be large enough to make possible continuous use of the machines; (2) the improvements in transport whereby its costs became so reduced that a large production in one centre would be more advantageous than a dispersed production serving smaller areas. The result was a growth in the unit size of business concerns. When, therefore, economic forces required some adjustment of supply, the shifting process was not the comparatively easy and rapid one of transferring a few small units, but the much more difficult transference of larger, and sometimes very

large, units. The stakes and resources involved often led to long-drawn-out and costly struggles to survive before the required adjustment took place. If, therefore, economic maladjustment was in these respects becoming more difficult to rectify, it was all the more important that serious disturbances of the economic equilibrium should be avoided as much as possible. The War, however, brought such disturbances on a scale previously unknown.

One further point is worth emphasising before the disaster of the post-war maladjustments can be realised, and that is the extraordinary complexity and interdependence of economic activities which had developed under the prevailing degree of economic stability. Consider, for example, the mass production of standardised articles; how the continuous output from the finish of the assembly line is the result of a tremendous rhythm, the synchronised arrival at various points in correct quantities of material which in its first movements may have started thousands of miles away and months or years ago. The organisation required is not so easy to build up but infinitely easier to smash. No authority could institute the rhythm, which has to grow up. The rhythm, if shattered, cannot be replaced by any authority but has to grow again. Or consider the innumerable decisions and actions which resulted in day by day a continuous supply of a very great variety of food-stuffs pouring into Great Britain without any noticeable glut or, compared to effective demand, scarcity. No one

can plan operations on that scale; they have to be a growth. Cut down, they have to grow again, and growth is a slow process.

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A category of the maladjustments caused by the War is not easy to compile. There are some items that leap to the mind: the actual destruction of fixed capital in the battle areas; the nearly thirteen millions killed or missing who would not be returning. Their absence did not make it any easier for the survivors to find work, for, if the thirteen millions were no longer there to compete for work, neither was their demand for commodities and services there to provide it. The problem of the replacement in civil occupations of the demobilised fighting services and the discharged munition and other war-servicing workers would have been troublesome enough if it had been merely a matter of putting them back in the jobs they previously had held, but, since the whole economic conjuncture had changed, this was possible only to a limited
held, but, since the whole economic conjuncture
degree. For example, the Scottish girls who worked with the fishing industry had been during the War drafted in considerable numbers into the making of Dundee sandbags for the trenches. After the War they could not all go back to the fishing industry since, apart from its disorganisation, the demand for salt fish from Central Europe was much less than it had been in 1914. That is but one example, and not perhaps a very important one. There must have been a very large number of

cases where a simple return to former work was not possible. Another problem to solve was how many of the women who had found work during the War emergency should be dismissed to make room for the returning men. It was obvious that many occupations, especially those catering to war needs, were overstaffed at the end of 1918, but it was not obvious where opportunities of profitable employment were to be found or, if found, to what extent they could provide work. Even where, as in housing, there was a clear demand for more workers to undertake the construction that had been held back during the War, there was a danger that the increased labour force would prove redundant as soon as the war-stopped demand had been met. Indeed, this danger was so obvious that in some countries the Trade Unions concerned refused to allow the dilution of their numbers by new entrants unless the Government would guarantee future employment.

It is, however, when we turn to international trade that the maladjustments caused by the War seem most impressive. The former channels of trade had become partly obliterated and many of the old trade connections broken. Countries which had been unable during the War to import goods in sufficient quantities, either because of submarines and blockades or because their former sources of supply were no longer able to provide the goods, had endeavoured to build up new industries at home. After the War, these industries, threatened with renewed competition from the old

sources, demanded and often obtained protection. Since the nations chiefly and most directly affected by the War were the industrialised countries of Europe, one striking outcome was that, when peace returned, world trade was no longer dominated by the exchange between industrial Western Europe and the raw-material-producing countries. Also, its organisation was less centralised in the United Kingdom.[1] The United States and Japan and, to a less degree, other countries remote from the conflict of war, had gained at the expense of Europe, and Pacific trade had gained on Atlantic. In Europe the creation of new States under the Peace Treaty had increased the number of separate Customs units from 20 to 27 and many of the frontiers had also been altered.

Some special cases will bring out more strikingly the changes that had occurred and the tremendous adjustments that were required. Germany, whose pre-war foreign investments had been about £1,250,000,000 and whose imports had exceeded her exports, had to build up an export surplus if she was ever to pay the reparations demanded, and to build it up in face of a Peace Treaty which, taking from her 13% of her European territory, including 20% of her coal and 75% of her iron, was in many respects aimed at crippling her economic development. The United States, a capital-importing country before the War, found herself a creditor nation at its close and needed to adapt her economy to a surplus of imports in

[1] League of Nations, *World Economic Survey* 1931–32, p. 145.

spite of her ingrained tradition of protectionism. Japan, whose industrial and mercantile development had been over-stimulated by war opportunities, was left with a larger and increasing population to maintain under less favourable conditions.

Or, if we turn from countries to commodities, the end of the War left production in a chaotic confusion. During the War, the area under wheat in Europe declined by a fifth, the consequent deficiency in supply being made up chiefly by the United States and Canada, where the area under wheat nearly doubled. Nearly one-quarter of the world's exports of wheat had, before the War, come from Russia, but Russian exports practically disappeared from the world market. The post-war adjustments had to work out the distribution of supply between North America, where the larger area had been reinforced by improved seeds and the mechanisation of farming, Russia with its spasmodic and arbitrary returns to the export market, certain nations of Europe where wheat production had been subsidised during the War, and some remaining areas such as the Argentine, India, and Australia.

In the years preceding the War, the output of beet sugar had been about as large as that of cane sugar, and the industry was prospering under the Brussels Convention of 1903 which had put a stop to the competitive subsidising of sugar production by various nations, the signatories agreeing to abolish all export bounties and to limit all other

methods of State assistance to a maximum of 2s. 6d. a cwt. (6 francs per kilog.). The Convention, however, lapsed in practice during the War and was officially brought to an end by the Treaty of Versailles. The War had reduced very considerably the production of beet sugar in Europe, partly owing to military operations in important areas of cultivation and partly to the general disorganisation of production and trade. This reduction provided an incentive to sugar production elsewhere, especially in the cane-producing countries, and considerable improvements were effected in the mechanical means of handling and transport and particularly in plant breeding and the control of parasites. By 1919–20 the beet sugar output had dropped to 3·3 million tons, the cane sugar output had risen to 13·3 million tons. After the War, it was clear that readjustment would have to take place between beet and cane, but since it was considered that to leave the adjustment to economic forces would have too savage a result on the cane-producing countries, especially in the face of the revival of competitive subsidising of beet, the subsequent story of the industry is one of attempted control by international agreement. The complete failure of these efforts is shown by the facts that, after seventeen years of repeated endeavour, Java, Peru, and San Domingo—contributing together only about 5% of the world's output—were the only countries producing sugar without State assistance; that for the ten years 1924–34 the whole cost of growing

beet in Britain was met by a State subsidy; and that foreign raw sugar was selling in London in February 1935 at less than half its cost. In 1936 the subsidies paid directly or indirectly to the producers of sugar throughout the world exceeded one thousand million dollars. The latest attempt to restore economic equilibrium in the sugar industry was made in 1937 by an International Sugar Conference which signed an agreement in London arranging for export quotas and establishing an International Sugar Council.

As a final example, let us take tin, the demand for which is very inelastic since it is used in connection with articles of whose cost the cost of the tin used is only a slight fraction. This means that if the price of tin goes up, consumption will not decrease very much, but also, if the production increases, the tin cannot be sold without a large decline in price. During the War, very large stocks of tin had accumulated, owing to the difficulties in getting shipping, in Singapore and the East. To prevent a disastrous slump in tin prices after peace was restored, the British and Dutch Governments attempted to control the price level and, by purchase, to aid orderly marketing. The attempts, however, of these Governments and of the Tin Producers' Association founded in 1929 and of the International Tin Committee can hardly be regarded as successful in restoring economic equilibrium, since in May 1937 the price of tin was £230 a ton although the chairman of one of the largest tin companies

stated that the East could provide at a profit all the tin the world needed at £100 a ton. The high price was due to the fact that restriction schemes, in order to be effective, have to include all producers. A quota had, therefore, to be allotted to the high cost producers, like Bolivia where tin is mined and not dredged, and the price had to be high enough to cover these costs.

Furthermore, when it is remembered that the reorganisation of world trade had to be attempted under the handicap of rapid fluctuations both in freight charges and in money exchange rates, the tremendous difficulties of the task can be better appreciated. As M. Theunis, the President of the Geneva World Economic Conference, said at its closing meeting on 23 May 1927: "The eight years of post-war experience have demonstrated the outstanding fact that, except in the actual fields of conflict, the *dislocation* caused by the War was immensely more serious than the actual *destruction*. The main trouble now is neither any material shortage in the resources of nature nor any inadequacy in man's power to exploit them. It is all in one form or another a maladjustment—not an insufficient productive capacity but a series of impediments to the full utilisation of that capacity."

It is possible that the maladjustments caused by the War might have been more quickly reduced had there been a general realisation that five years of destructive world-warfare must leave mankind poorer. A reduction in real wage rates, in interest

rates, and in profits was bound to come. Had it been possible at once to bring about such reductions on an equitable basis, the reconstruction of prosperity would have had a better start. As it happened, much effort, that might have been given to healthy restoration, was wasted in selfish struggles by various groups of interests to avoid the necessary adjustments. Every class, every industry, and every nation struggled to defend its own position and, if possible, to throw a disproportionate share of the burden on others. Restrictive schemes and policies, aiming at valorisation, were more and more widely adopted, and presented rigid blocks impenetrable to the shifting and sifting process which, working only in narrower fields, found the required readjustments all the more difficult and distressing. To quote again M. Theunis: "The main obstacles to economic revival have been the hindrances opposed to the free flow of labour, capital, and goods."

Nevertheless, and in spite of the constant recurrence of new maladjustments caused by changes in Government or industrial policies, the wounds in the economic tissue started to heal by the granulation of the shifting process, obedient, as far as might be, to the profit motive and the price mechanism. If the world had had a period of quiet convalescence, much might have been accomplished and more quickly, but, as in the days of Jeremiah, we looked for peace but no good came, and for a time of healing and behold trouble! Yet, one has to conceive of the whole economic organism of the

world as permeated by this healing shifting process; throughout the whole of post-war economic history, this process has been at work, meeting many rigidities, rebuffed by the entrenchments of privilege or economic power; its work often nullified, though sometimes aided, by changing Government policies; its own influence so diffuse and atomic as to be appreciated in theory rather than manifest in practice; seeming—to change our metaphor—scarcely anywhere one painful inch to gain and yet slowly and silently flooding in. Little further will be written in this book of the shifting process, but it continues, as before the War, to be the least dramatic but most potent force making for economic equilibrium and the optimum production of wealth. As Professor Cassel says: "If any lesson has been brought home to us by our post-war experience, it is this: that the business world has a wonderful capacity for adjustment, once it has been made perfectly clear what it has to adjust itself to."

One of the complicating difficulties of the post-war era has been that the shifting process has been increasingly interfered with, and obstructed by, Government action. Some important industry finds demand shrinking as human needs and preferences change, or it may find that new methods of production can maintain the output without the need of so many workers. In either case, economic adjustment in the general interests of the community requires a transference of workers to some other activity. The actual course of events, however,

may be threatening the discharge of a large number of workers without the prospect of their immediately finding the new job. They will not get absorbed at once in industry and meanwhile they are faced by an indefinite period of distressful unemployment. The Government endeavours to prevent the distress, but any attempt to speed up the rate of absorption by other industries is very difficult since no Government can know where these real opportunities for additional employment exist. It resorts, therefore, to the easiest solution; help is given to the first industry so that it can continue employing the same number of workers. In this way the subsidising of industries prevents that economic adjustment of supply to demand which the circumstances really require. Moreover, the subsidy, since it is largely levied on the prosperous industries, is a handicap to them and there is further distortion from the best uses of the productive powers of the country. Subsidies have been given, in particular, to agriculture in many countries, but, whatever social reasons may be adduced for this, it ought to be evident that, if the mechanisation of agriculture and the improvement of seed grain has made it unnecessary to have so many farmers to-day as formerly, it is a waste of human endeavour to keep them all farming.

Before passing on, one additional consideration deserves attention. The shifting process is greatly assisted by the growth of new industries able to absorb easily large numbers of workers and to use profitably much capital. The automobile and

artificial silk industries, not now entitled to be called "new", have been expanding ones, while the post-war years witnessed the helpful rise of industries concerned with the radio, many domestic electric appliances, aircraft, and plastics.

CHAPTER II

THE LEGACY OF DEBT

THE direct cost of a war is a burden that has to be borne by the people during belligerency. Current costs have to be met out of current income. Neither the fighting forces nor the workers in the Government supply and administrative services can be fed, clothed, and equipped by promises. In so far as these people have been helping to produce marketable commodities, they cease to do so, and, therefore, in order to supply their needs, the rest of the community has to restrict consumption, either compulsorily, because their money is taken away by taxation, or voluntarily when it is handed over as subscriptions to war loans.

Taxation may be in the obvious form of an assessment, or in the obscure form of currency depreciation through inflation. The degree to which various Governments on a war basis financed themselves by taxation, which they were under no obligation to repay, rather than by loans, which promised repayment with interest, varied considerably. The United Kingdom collected by increased taxation revenue an amount sufficient to pay one-third of the war cost during the time it was incurred. Her total war costs, estimated at over 10,000 million

pounds, were so great that the expenditure of the Government during the war years exceeded in figures its total expenditure for the whole of the preceding two hundred years. If a person spent in five years as much as his ancestors had spent in two centuries, he could not hope that such a debt—for without tremendous borrowing such expenditure would be impossible—would ever be paid off. Is there any reason to suppose a nation could?

Two-thirds of the British war cost had to be met by borrowing by the British Government, and the National Debt which on 1 August 1914 had been 711 million sovereigns held by about 345,000 investors, was at the end of 1919 8,078 million pounds held by over 17 million investors.

The United Kingdom and the United States were the only nations to meet any material part of the war costs by increased definite taxation at the time: other countries simply raised the money in loans, in so far as they did not resort to the printing press. The difficulties of the war years made it necessary even for neutral countries to increase their national debt; only one country, Uruguay, of the 37 reporting to the Brussels Monetary Conference of 1920, had reduced its debt during the war period. The national debts of 40 of the world's leading countries were, at the end of 1919, estimated at 220,000 million dollars, an increase of 190,000 million dollars in six years.

It is not necessary to quote any more figures to make the point. The War left a legacy of debt

which it was impossible to carry. There had to be default.

Just as one of the main aspects of post-war economic history is the continuous effort to correct the maladjustments caused by the War, so another is the continuous effort to deal with the debt problem, and the unfortunate fact was that most of the latter effort only set up further maladjustments. Increased taxation shifted effective demand from the taxed to the recipients of Government expenditure, besides discouraging enterprise. Worse still as a cause of further maladjustments were the defaults, total or partial, when the strain of attempting to carry the debt became too severe or too dangerous. Defaults, happening spasmodically with no possibility that anyone would foresee at all certainly in what countries, at what time, or to what extent they would come, increased confusion and undermined confidence. Particularly was this the case with the insidious and not popularly understood form of partial default called inflation. As currency or credit inflation reduced the purchasing power of money, a very considerable crop of new maladjustments arose. Debtor classes gained at the expense of creditor, people living on fixed incomes suffered, and in various other ways effective demand was shifted from group to group so that compensating shifts were required in the direction of productive enterprise, shifts which were all the more difficult to accomplish in the face of the prevailing uncertainty as to how far the inflation was going and at what pace. In countries where

inflation was carried to extremes, the result was broadly to throw the middle classes back into the ranks of the proletariat and to wipe out middle-class demand.

In addition to the domestic difficulties caused by the swollen national debts, there were also international debts and, in particular, the irritant obligations of the payment of Reparations and of inter-allied War Debt, involving the very troublesome problem of transfer. To take a concrete case: if the United Kingdom had to pay the United States in dollars, it could only do so by obtaining the dollars in exchange for goods, securities, services, gold, or pounds. Apart from the relatively little that could be accomplished by providing additional services or by selling British holdings of United States securities or British securities to United States citizens, the payments could only be made by exporting goods or gold, or by exchanging money. Even if a reduction in the standard of living in the United Kingdom had reduced wages and costs and enabled an export surplus to accumulate, this method of payment would have been long and troublesome, for, with every increased quantity of goods sent, the selling price would tend to drop and, if sales were pushed too rapidly, a point might be reached where a larger amount of goods would, because of the fall in price, give command over fewer, and not more, dollars. The political wisdom of not forcing down wages too much in the United Kingdom and the protectionist policy of the United States made, however, any attempt

to pay the debt in goods practically impossible. To pay the debt in gold, besides the consideration that the total gold holdings would only have paid a very small part of the debt, would have drained all the gold away from the United Kingdom and, as opinion then was, would have caused a financial panic. To obtain the dollars by selling pounds for dollars on the exchange market would have depreciated the foreign exchange rate of the pound and upset international trade. Moreover, if the debt payments had been sufficiently large and rapid, a point might have been reached when the more you paid, the more you had to pay, since more and more pounds had to be given to obtain the same number of dollars. The British case is only mentioned as an example. All unilateral payments present these difficulties. The payment of interest on capital borrowed internationally in peace time does also; but such capital is generally used for productive purposes and generates its own flow of new wealth out of which to pay the debt. The borrowings for war purposes produced no such increment of wealth.

One result of the heavy borrowing during the War was the collapse of the gold standard. Heavy borrowing by a Government induces price inflation. Many of the people who buy the Government bonds raise money on their security, with the result that both the Government and the bondholders have the money to spend. There is increased spending power and, as commodity prices rise generally, the purchasing power of the monetary unit falls. If people were allowed to redeem their money at the

parity rate in gold they would do so and export the gold to enable them to increase their purchases in countries where prices had not risen so much. Hence in all the belligerent countries the export of gold was prohibited and the monetary unit continued to depreciate in value.

At the close of the War, the world's currencies were in a chaotic condition. There was no way of knowing what one currency was worth in terms of any other beyond a comparison of what they would each buy in their respective countries. Such comparisons could, from their nature, only be rough approximations. For example, the pre-war mint parity of the British sovereign was $4·86. By December 1918, the price-level index number in United States had doubled, and had prices in the United Kingdom remained as in 1913, the pound would have been worth twice $4·86. But British prices had more than doubled and the British index number was 2·3 times the 1913 figure. Hence the new relation, the purchasing-power parity, was below the old 4·86 figure and somewhere about $4·25. This relation, however, only reflected the estimated purchasing-power parity at the time, whereas the actual exchange rate was considerably affected by considerations of what it was likely to become. Britain having won a finished war, it was expected that the pound would rise, and therefore people were willing to, and did, give $4·75 for a pound that was presumably at the moment only worth $4·25.

The following table shows that at the end of 1918

the exchange rates of the currencies of the victorious allies were all above the dollar purchasing-power parity while the reverse was the case for the currencies of the defeated powers. A year later, after artificial support to the currencies had been withdrawn and when the future prospects were better appreciated, all four currencies were lower in terms of dollars—or gold, for the dollar was now back on the gold standard—and the expectation that the currencies of the victorious allies would appreciate had evidently changed to an expectation of further depreciation.

	United Kingdom $ per £ Mint parity—$4·86		*France* cents per franc Mint parity—19·29	
	Purchasing Power parity	Average Exchange rate	Purchasing Power parity	Average Exchange rate
December 1918	4·27	4·75	11·04	18·36
December 1919	3·93	3·81	9·23	8·48

	Italy cents per lira Mint parity—19·29		*Germany* cents per mark Mint parity—23·82	
	Purchasing power parity	Average Exchange rate	Purchasing power parity	Average Exchange rate
December 1918	10·47	15·72	19·64	12·09
December 1919	9·45	7·66	6·62	2·10

The benefits of the gold standard have been better appreciated since the world has left it. It stabilised,

to the very great advantage of international trading, the currency exchange rates within the very narrow limits of the gold points. Unsound finance and over-borrowing by Governments were largely prevented by the certainty that they would be exposed through a drain of gold. In both respects confidence was established and maintained; confidence in the domestic currency and confidence that foreign trade could be carried on without the fear of exchange losses. The gold standard kept the general level of prices, in all countries adhering to the system, in harmony and distributed the world's gold according to need. It is true that the system required that somebody should always be willing to buy surplus gold at a fixed price, but there was always such a buyer of last resort in the Bank of England, and the surplus gold so obtained was eventually distributed to the best advantage by lending capital in the most promising foreign fields of enterprise. The gold standard had its defects. The pace of economic progress was to some extent dependent on improvements in the banking system economising gold or on the fortuitous discovery of new gold-fields or better methods of treating ores. Otherwise, commodity prices fell with increasing production and, until costs could be adjusted downwards, economic activity was slowed down. Conversely, the discoveries of new gold-fields and the introduction of the cyanide process led to a higher level of world prices and, until wages could be adjusted upwards, economic activity was abnormally profitable with the usual result that over-optimism was

generated and the mistakes of a boom period led to an eventual crash.

To those who were looking back from the chaotic currency conditions of the post-war years, it seemed that the gold standard, in spite of its inherent disadvantages, was infinitely preferable. Accordingly, another clue to post-war economic history is *the effort to restore the gold standard.*

CHAPTER III

THE LEGACY OF DISTRUST

ALL wars leave a legacy of distrust. The citizens of the defeated countries distrust those who have led them into a losing war and demand a different Government and perhaps a different Constitution. They distrust also the victors and suspect that the terms of peace mask an intention to hold them in permanent subjection. The victors distrust the vanquished and fear a subsequent war of revenge if, and as soon as, the latter recover their strength.

The legacy of distrust from the Great War, however, went deeper than this. In the popular mind of the Christian countries there seems to have existed, before the War, a too bland and complacent belief that Providence would shield mankind from any really serious catastrophe, a too slack conception of what was involved in that duty of human co-operation of which St. Paul reminded the Corinthians when he wrote that we are labourers together with God. A benevolent Providence, it was thought, might occasionally have to visit the sins of humanity with plague, pestilence, and famine, as a chiding reminder, but the popular belief persisted that such scourgings would never

be intolerable. Moreover, such visitations were met rather by a vague sentimental repentance than by a reform of conduct. It is symptomatic that Edinburgh, during the cholera scare of 1853, needed to be told by Lord Palmerston that it was better to proceed in the work of sanitary purification and improvement than to proclaim a national fast. The belief that there is a Divinity doth shape our ends was too popularly understood to mean that a certain amount of rough-hewing might be condoned, God was in His Heaven and all was right with the world, and somehow good would be the final goal of ill. Whoever wrote "our times are in Thy hands, why need we doubt or fear? A Father's love will never cause His child a needless tear", might have been prepared to justify his opinion, but he would not have been able to justify the too general interpretation that this excused mankind from any strenuous efforts towards the safeguarding and improvement of the fundamental conditions—and, in particular, the maintenance of peace and justice—that make for human welfare.

There is no doubt that the World War, with its tens of millions of killed and maimed, gave a profound shock to accepted faith. It added to the number—possibly formerly increasing—of people who regarded as quite unjustifiable the postulate that there must be some more or less personal power in control of the world. To others it came as a distressing discovery to find how much more widely than they had supposed possible the Earth

could swing from God's intent. To the atheist there was no God to prevent war; to the faithful it had been proved that, given a sufficient degree of human dereliction, almost utterly devastating wars could come. To all, therefore, appeared the need to organise the benevolent desires and forces of humanity so as to still the outrages of violent and unruly peoples and preserve peace. The attempt was made in the foundation of the League of Nations. To the ordinary man, the League was to prevent war; the statesmen may have had more attainable and more limited objectives, and Lord Grey in 1925 spoke of the suppression, localisation, or insulation of war. Popular enthusiasm for the League was, however, based on the assumption that it would maintain peace.

Whatever may be the future of the League, it has not been able to prevent war and does not appear to be likely to do so in, at least, the immediate future. Faith has been lost in the absolute prevention of wars by any superhuman intervention in, or direction of, human affairs, and it has now been lost in the ability of mankind to secure, as yet, that international co-operation which, it was hoped, might have achieved the same end. The world has been thrown back upon a gangster policy dominated by fear. A precarious substitute for security is sought by the herd minimising all dependence on outside elements, by the elimination of alien constituents, and, as in all gangs, by periodical panic-stricken purges

of suspected traitors within. Uneasy alliances with other gangs, all armed to their economic capacity, are possible only because their mutual distrust is less than their fear of opposing groups. There may be to-day, as Mr. Well's Dr. Norbert asserted, an increasing malaise of fear that the world is no longer safe for anything.

Whether the above picture be overdrawn or not, it will hardly be disputed that the experience of the War and the armed Peace has been profoundly disillusioning. It has generated a predisposition to discard the faiths and principles that had hitherto been accepted guides and to experiment with new ways and means, often looking towards quite novel objectives. There is a modern urgency for change, irrational change, change for its own sake and irrespective of the probable results, and the strength of the urgency is partly due to the lack of that steadying influence which the missing generation—missing, because of the War casualties—would have brought. This modern urgency for change is exhibited in all fields of human endeavour and what particularly distinguishes it from former progressive impulses is that the modern desire seems no longer to be to improve, patch, and reform, but to break away from tradition and from hitherto accepted rules and boundaries and to launch out into something entirely different. To take a somewhat ludicrous example: there has always been a desire to invent more comfortable or more becoming styles of dress or costumes better adapted to human

requirements; now a movement has arisen to discard clothes altogether.

Manifestations of this urge to experimentation are breaking through in all sorts of human activities, in literature, painting, music, architecture, and transport, as well as in politics,[1] and in all fields of human speculation, in physics with its new conceptions of space, time, and matter, as well as in political philosophy. The break with traditional technique is very clearly seen in the writings of such authors as James Joyce, Gertrude Stein, and E. E. Cummings, in jazz and swing music, in the paintings of the Surrealists, and in some cases it is a break not only in technique but in ultimate purpose.

This distrust of old ways and former beliefs with its natural corollary in the urge to experimentation is mentioned here because it has its influence also upon the economic history of the post-war world. The general disillusionment led to readiness to condemn existing institutions merely because they were existing, and to demand change. How much weaker now than before the War is the belief in free competition, in the Capitalist system, in the gold standard, in free trade, in parliamentary representative government, in a liberal education, and, indeed, in all that body of doctrine known as orthodox political economy. Much that has

[1] For example: "The country needs and, unless I mistake its temper, the country demands, bold, persistent experimentation. It is common sense to take a method and try it; if it fails, admit it frankly and try another. But above all, try something."—President Roosevelt.

happened in the economic field could not have done so had these beliefs not been seriously weakened, and an appreciation of this background of distrust plays a necessary part in the understanding of the actual economic changes. How much of this distrust was warranted must be left to the reader's judgment, now that the warning has been given that there has existed a bias in favour of change. The conclusion ought not to be that new ways and new deals are better than old, new doctrines better than former ones, merely because they are new. It is still, surely, uncertain that economic nationalism is an improvement on free trade, that authoritarian economic planning gives a better result than free enterprise, that currency control is to be preferred to free exchange, that dictatorships give happier results than democracy, or, indeed, that everything taught by the older economists has lost whatever validity it may once have had. The legacy of distrust may be sweeping us too far from the truth.

Here, too, may be mentioned that the legacy of distrust is regarded by many sociologists as partly responsible for that decline in the birth-rate[1] which is likely to have much more serious economic

[1] Some examples of the fall in the net reproduction rates, i.e. the probable number of girls to whom a newly-born girl will give birth, assuming that the rates of fertility and mortality remain constant.

England and Wales	1920–22	1·35	France	1920–23	0·97
	1934–36	0·87		1935	0·86
United States	1930	1·07	Sweden	1921–25	1·05
(white population)	1935	0·96		1935	0·70

consequences in the last half of the century than many people yet realise. "The proper way," writes Dr. Hagstroem, "to deal with this problem would be to try and revive that buoyant view of life and faith in the future which is indispensable for any productive activity."

CHAPTER IV

THE FIRST SLUMP IN PRICES, 1920–22

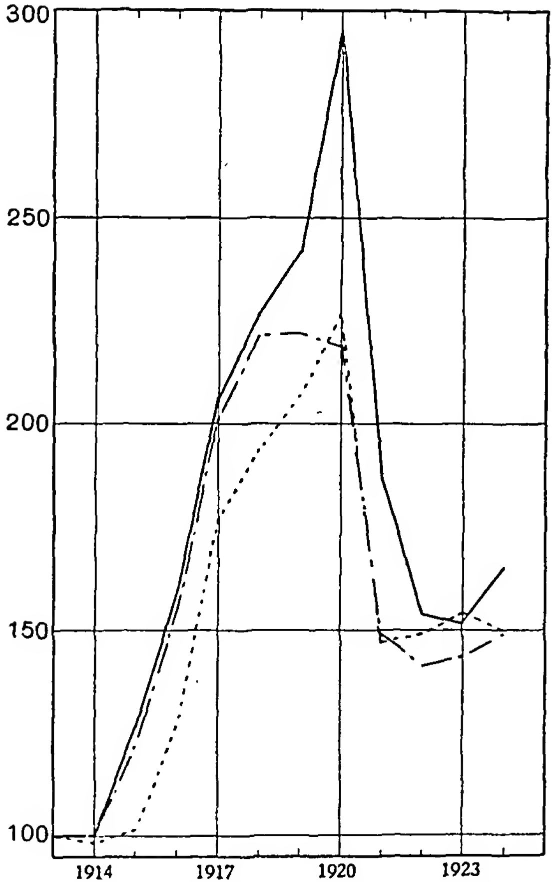
The first peace year, 1919, was a confused year of liquidating war contracts, demobilising the fighting services and munition workers, and the emergence of demand postponed during wartime. The first World Conference was held in Brussels in 1920. It was not a Conference to endeavour to correct economic maladjustments, nor a Conference to deal with the impossible burden of debt, but a Monetary Conference aiming at restoring order in the monetary field and ultimately at the restoration of the gold standard. The main recommendation of the Conference was that deficit budgeting should be stopped as soon as possible. In the year 1920 deficits occurred in the budgets of eleven out of twelve European countries represented, and in the budgets of three out of four of all countries represented. Deficits, so long as they continued, had to be met by further borrowing, hence more inflation and a continuation of currency depreciation with all its evil effects, of which the two most serious were (1) the rising cost of living leading to social unrest among people who sincerely but unreasonably expected better conditions after the five years war was over, and (2) the hampering of trade through fluctuating

exchange rates. If budgets were made to balance without further borrowing, it was hoped that depreciation would cease and the currency units tend to settle down at some recognisable values. When this had been accomplished, appropriate lower gold contents could be ascribed to the various national currency units, and the gold standard system could be revived.

The Conference was aware that this stoppage of further inflation could not start at once in all countries. It was impossible, for example, for France faced with the immediate need to rehabilitate the devastated areas. Moreover, a sudden stoppage of inflation was likely to cause disturbance in credit and trade, and possibly produce a monetary crisis. The process would have to be undertaken gradually and with care, and the recommendation was therefore added that Central Banks, free from political pressure, should be established in all countries.

It was natural that the Brussels Conference should have been impressed with the need to stop further inflation. World prices had risen during the War years in an unprecedented manner. The British index number of wholesale prices, 1913=100, had reached a peak of 313 paper (253 converted to a gold basis) in April 1920. In many other countries the fall in the purchasing power of the monetary unit had been greater. To continue on this slide was only drawing nearer to the abyss. Unfortunately, the Conference did not realise that deeper economic forces were at work which would have stopped the feared further rise in prices. What the world

PRICE LEVELS (1)



INDEX NUMBERS OF WHOLESALE PRICES

——— Great Britain (gold basis)

...... United States

needed was neither further inflation nor a deflation of prices; it required the help which steadier prices would have given towards the reducing of the great economic maladjustments.

The first of the major post-war catastrophes was the tremendous slump in world prices which started in Japan in March 1920. Why this came to the extent it did is not too simple completely to explain. There had been considerable bullish speculation in the markets, caused partly by the flood of currency ceasing to go into new war bonds and seeking other outlets, and partly by the natural, if mistaken, feeling that everything would be better now the War was over. The presumption that some endeavour to follow the recommendations of the Brussels Conference would be made probably caused many to expect that prices would, if not fall, cease rising, and the natural result was a crash in the commodity and security markets which came in the summer of 1920. Such a crash always destroys confidence.

That the crash started in Japan was probably due to the particularly rapid economic developments in that country under the unhealthy stimulus of war demand. By 1920 there were 19,000 million yen of notes in circulation as against 385 million in 1914. During the War years new companies capitalised at a total of 2,340 million dollars were floated. With the restoration of peace, it should have been obvious that very considerable adjustments would have to be made, yet the speculative boom continued. In 1919 capital promotions

amounted to 2,150 million dollars and in the first three months of 1920 more companies were floated than in any previous years. Many industries were clearly over-capitalised; the important cotton industry, for example, had increased its capitalisation during the war years by 60%, although its production had increased only 20%. Prices had risen greatly, and in the spring of 1920 the price of rice was four times higher than it had been two years previously. The effects of boom conditions are cumulative and enhanced by the infectious general optimism. Unless the boom is to reach absurd heights and crash from its own weight, the banking authorities have to try and stop the wild speculation and the rising prices, and their method is to tighten up on money rates. The difficulty of checking a rise without precipitating a crash is always great, and the larger the boom, the greater the difficulty. As soon as it is seen that prices are ceasing to rise, there develops a flood of selling, particularly by speculators carrying stocks on borrowed money. The Bank of Japan raised the discount rate until, by the end of March 1920, the rate was nearly 10%; call money at the same time had advanced to 12%. A flood of selling developed into a veritable panic on 17 April and both the produce and stock exchanges had to be closed.

Developments in the United States were very similar to, and about contemporaneous with those in Japan. As wartime controls were relaxed, there was credit expansion all through 1919 accompanied by rising prices and increasing speculation.

The efforts to control these developments were delayed by the Government's desire to maintain cheap money rates until the Treasury had reduced the unwieldy floating debt. In the last week of January 1920, however, the discount rates of the Federal Reserve Banks were raised, and further increases were made until the rise in commodity prices was checked in May. Collapse followed. It is said that the liabilities of insolvent business houses were over three times as much as in the panic year of 1907, and for the first six months of 1921 there were 4,120 more suicides than in the first half of the preceding year.

The crash in the credit and price structures in Japan and the United States was paralleled in most of the important commercial countries, where it came partly from similar causes and partly by repercussion.

There is no question but that it was inevitable that the inflation of prices and speculation would have had to stop, and it was advisable to stop it before it soared to such dizzy heights as, without interference, it might have reached. The catastrophe was not the breaking of the boom, but the tremendous crash in the world price level that followed.

Highest Point of the Rise

	Date	Index Number of prices: 1913=100
United States	May, 1920	247
Great Britain	April, 1920	313
France	April, 1920	588

Lowest Point of the Fall

	Date	Index Number of prices: 1913=100
United States	January, 1922	138
Great Britain	September, 1922	150
France	February, 1922	306

It will be seen that the fall in prices was such that all debts were practically doubled in burden. For it is essential to realise that a fall in prices does increase the burden of debt. A farmer who owes a thousand dollars can pay the debt with a thousand bushels of wheat when wheat is at a dollar a bushel, but, when the price drops to fifty cents, he needs to produce twice as many bushels in order to meet his obligation. Very grievous, and perhaps impossible to carry, was the burden of debt at the end of the War, but now this burden was doubled. It was no longer Government debts, reparation payments, and inter-ally war debts, which provided the sole debt problem; all debts, commercial and private, were becoming impossibly onerous. Particularly did this hit the farming populations, for, while manufacturers can meet falling prices to some extent by lessened production and reduced costs, the farmer is usually unable to do so. His natural reaction to a falling income is to produce more rather than less, only to find price collapsing even more drastically. Many of the difficulties which later beset agricultural communities—and had so many repercussions both in economic and political fields—had their origin in the price fall of 1921.

It is interesting to speculate on what would have been the course of post-war economic history had the 1920 spring level of prices been maintained.[1] It is certain that the world would have had an easier time; many of the further maladjustments, caused by the fall in prices and by the subsequent efforts at ameliorating particular conditions, would never have arisen.

Neither of the two countries to which the War had brought exceptional prosperity and rapid development—Japan and the United States—was competent to take the leadership in monetary policy. Japan was a comparatively new industrial country —the Bank of Japan was founded in 1882. The United States had only reformed a completely chaotic and irresponsible banking structure in 1913, and the Federal Reserve authorities then established had since had no experience of anything but abnormal war circumstances. Both countries made the disastrous mistake, not of breaking the boom which was necessary, but of sticking to high money rates long after the rise in prices had been checked and optimism had passed into business depression. It is a well-established rule that as soon as credit restriction has checked speculative and rising prices, money rates should be lowered at once in order to check the back swing. The support, which easier credit conditions would have given, was not provided; distress selling of assets to raise money continued and prices plunged to unnecessary

[1] "Finland almost escaped this crisis owing to the fact that it maintained a stable price level from 1920–1922." Ohlin, *Course and Phases of the World Economic Depression*, p. 110.

depths. In Japan, in the latter part of 1920, commercial bills were still being discounted at 9½ to 11%; the discount rate was not dropped to 6% until May 1921. In the United States, the Federal Reserve Board held on to a 7% rate, established in June 1920, for nearly a year; the New York Federal Reserve Bank reducing its rate to 6½% on 5 May 1921, though by the end of that year the rate was down to 4½%.

The appreciation of the purchasing power of the dollar as prices fell in the United States was particularly unfortunate for Great Britain. The British Government had decided, following the report of the Cunliffe Committee in 1919, to endeavour to restore the pound to its former gold parity value. The decision was made primarily for reasons of prestige and in the interests of maintaining London as the world's greatest financial centre, but it was recognised as well that the whole country benefited by the profitable financial activities of London and it may have been thought that the restoration of value was the honest thing to do. The British policy, therefore, required a steady deflation of prices whereby the pound would gain in purchasing power. The United States had removed the embargo on gold export in June 1919 and thenceforward the dollar represented gold. At the end of 1919 the pound was worth less than four dollars, but as it gained in purchasing power, so the exchange rate would move favourably until, when it had reached the pre-war parity exchange of 4·8665 dollars, the pound would be back at its

former gold parity and the gold standard could be restored in Great Britain. The price deflation in Great Britain was, of course, harmful to industry, mainly because wages could not, in the then existing state of public sentiment, be reduced as the cost of living fell. Unemployment increased. The injury to industry was, however, considered to be outbalanced by the advantages that would accrue from the restoration of the gold parity value of the pound, since the gap to be closed was not so very great. But, after the fall in prices started in the United States, the pound was no longer painfully climbing towards a stationary dollar; it was pursuing a fleeing one. The strain became more intense as the chase became longer.

The price level in the United States ceased to fall in January 1922, for which month the average quotation of the pound was 4·225 dollars. From that date onwards, the restoration of the pre-war parity of the pound, on which the British had set their hearts, could only be accomplished by an appreciation of the pound or a depreciation of the dollar, or both; in other words, by price deflation in Great Britain[1] and price inflation in the United States. Both policies had their dangers; in Britain of deepening business depression, increasing unemployment, industrial trouble and discontent; in the United States of rising prices, rising profits, the wild speculation of a boom and the eventual crash. Looking ahead for a moment, we see that both

[1] After the low point of September 1922, the British policy of deflation was more evident as a restraint on the rise in prices than as an actual further fall.

policies, affected and conditioned by many other happenings, were worked out to their dénouement: the British to the general strike of 1926, the American to the mass speculation and crash of 1929.

The most important and broadest significance of the fall in world prices which started in the spring of 1920 was that it made an already extraordinarily heavy debt burden impossible to carry. Sooner or later most countries were driven to write down debts, not openly as the unjust steward did, but choosing usually the method of devaluation, keeping the name of the monetary unit and the nominal figure of the debt while reducing the value of the unit in terms of gold.

CHAPTER V

THE FIRST DEVALUATIONS, 1923–28

THE fall in world prices, which by the time it reached its nadir in 1922 had doubled the debt burden, made a resort to devaluation of currencies inevitable. Government revenues fell as business dwindled and incomes decreased with the falling prices, but Government expenditures tended to mount with the disbursements on war pensions, the increasing interest payments on a swollen and swelling national debt, and the costs of social rescue work in a period of acute depression. The budget deficiencies, which the Brussels Conference had desired to end, continued; Government borrowing continued and with it the depreciation of currencies. The period was particularly confusing because, while the falling prices tended to increase the value of the monetary unit, Government borrowing or direct currency inflation tended to decrease it. A devaluation of currencies while these processes were continuing would have been futile; it was not until they had ceased that the currency unit would settle down at a value which might be sufficiently recognisable to permit a useful devaluation.

The World Economic Conference, Genoa, 1922

In April 1922 an international Economic and Financial Conference met at Genoa. The main effort of the Conference was an attempt to restore order in the monetary field, since, as the first resolution of the Currency sub-commission stated, "the first essential for the economic reconstruction of Europe is the achievement by each country of stability in the value of its currency". The Conference adopted the following proposals: (1) that the restoration of a gold standard should be accepted as the ultimate object of monetary policy, and (2) that, to attain it, each Government should balance its budget and should, as soon as its currency had settled down to a reasonably stable value, determine and fix the gold content of the monetary unit. In essence, this was a repetition of the recommendations of the Brussels Conference, but the Genoa Conference went further in advocating a gold exchange standard for most countries in order to avoid the appreciation of gold which, if all countries had to accumulate gold reserves, might have been the result of a scramble for gold. Each country, the Conference agreed, was to be responsible for the maintenance, after any necessary devaluation, of the international value of its currency at par, and was to be left entirely free to devise and apply the means, whether through regulation of credit by a Central Bank or, in a somewhat vague sense, otherwise. Though fiscal

autonomy was thus assured for each country, the Conference stressed the advantage of continuous co-operation by Central Banks, and in particular recognised that something would need to be done to prevent undue fluctuations in the purchasing power of gold itself.

This programme of monetary reform has long held the field, and perhaps still does, as the only cure for monetary instability. The Conference concluded by recommending that the Bank of England should call a meeting of Central Banks to consider these proposals and to make recommendations to their respective Governments for the adoption of an International Monetary Convention along these lines. Such a formal meeting never eventuated and the Central Banks of the world had no regular opportunities for collaboration until the Bank for International Settlements was established in 1929. As a result of this failure, for which the Bank of England was not to blame, no international control over the value of gold was established and the lack of this control, as will appear, was disastrous. In other respects, however, the programme was broadly followed by the various countries. After 1922 the price level ceased falling, the fluctuations of many currencies subsided, and devaluation became possible and advisable.

Devaluation has in later times sometimes implied the deliberate reduction of the gold content of the monetary unit below its existing value, but in these first devaluations it only meant a legal recognition of an established condition. The monetary

unit had lost a portion of its value; the legal act of devaluation was intended merely to link the existing value of the unit to its equivalent gold value, thus establishing a new gold parity different from the former lost parity. The advantage of devaluation was that it opened the way to stabilisation and a return to the gold standard on a basis that it was hoped would prove tenable. Furthermore, the act of devaluation was in the nature of a declaration that the Government concerned considered that successful efforts could be made both to balance their subsequent budgets, thus avoiding future price inflation, and to maintain the new value without the need for price deflation. Devaluation gave a fresh start and renewed confidence.

With all the advantages that such a fresh start, when possible, would have given, there was, nevertheless, a considerable reluctance to devalue. The interests of the creditor and rentier classes were against devaluation; to many it seemed unjust and dishonourable; the prestige of the country's international credit status might be impaired; and, in particular, the precise time and correct new parity were very difficult to select and mistakes would be penalised. It was not, therefore, until 1924 that most of the devaluations took place.

In 1923 while most countries were still struggling against the need openly to avow the depreciation of their monetary units, two events of very considerable importance occurred: the Earthquake in Japan and the Occupation of the Ruhr valley by the French.

The Earthquake in Japan, 1923

Japan had accumulated, during the war years, very large reserves of gold and devisen[1] in foreign centres. When the fall in prices came in 1920 and especially hit the important silk industry, a luxury trade peculiarly liable to wide fluctuations in demand, the policy was adopted of supporting the exchange value of the yen by drawing on these foreign reserves. It was a policy which eased the distress of deflation in Japan, but it resulted, not only in the rapid depletion of these reserves, but also in giving the yen an exchange value higher than its purchasing power parity, thus bestowing a premium on imports into Japan. Such a policy could not have been continued for long in any case. However, the situation was blown up by an extraordinary catastrophe that could not have been foreseen. The earthquake of September 1st, 1923, destroyed Japan's chief port and a large part of the capital city; it upset productive capacity and necessitated large imports of reconstructional material; it is estimated to have caused the loss of over 100,000 lives and to have destroyed property to the value of many billion yen.

To tide the country over the immense losses sustained, the Government ordered the Bank of Japan to rediscount all pre-earthquake bills, and by the end of March 1924, 430 million yen of these

[1] The word "devisen" is used to mean easily liquidated funds held by a Central Bank in a foreign centre.

bills had been rediscounted. When these bills reached their dates of maturity many could not be met, and the dates had to be repeatedly extended. The facts that the assets of many banks tended to consist largely of frozen bills which could not be liquidated and that many of the debts owed by business men were not recoverable, such bad debts involving the solvency of their creditors, led eventually to a financial panic which became acute on 19 April 1927 when the Bank of Taiwan closed its doors. Runs on other banks followed: 617 million yen appears to have been withdrawn by depositors during the panic; several other banks failed, and on 22 April the new Tanaka Government proclaimed a three weeks moratorium.

The real significance, from the point of view of world economic history, of the earthquake of 1923 and the consequent financial crisis of 1927, may be considered to be that these events postponed for several years the attempted solution of Japan's fundamental problem of how to support her largely increased and increasing population. For many decades up to 1920 the birthrate in Japan proper had shown, in contrast to other countries, an accelerating increase. In 1920 the birth-rate reached a peak of 36·2 per thousand of the population, which was then 56 millions. Since then, the net increase of births over deaths has been about one million a year. Her people could not grow enough food in their mountainous islands whose arable area is of very meagre proportions; they were not

permitted entry as immigrants into many countries, nor could they obtain enough food in exchange for their manufactured goods if tariff barriers were constantly erected against Japanese goods. Under such circumstances, the Japanese statesmen endeavoured to find an outlet for their people, a market for their goods, a store of supply of foodstuffs, and a field of enterprise, in the land area nearest to them: China. The development of the potential wealth of the Chinese Empire and a greatly increased trade between the two countries would have gone far to solve Japan's national problem. The Chinese, however, proved themselves unwilling to co-operate as readily and as fully as the Japanese desired, and the decision was ultimately taken to compel by military force a co-operation that was not otherwise forthcoming to the extent demanded. It is clear that such a hazardous policy of virtual conquest could not be undertaken except under the most favouring conditions. Japan had to wait for her opportunity until she had recovered from the catastrophe of 1923 and from the financial débâcle of 1927. Even so, it was not until Europe was involved in a severe credit collapse in 1931 that Japan made her first hostile advance into Manchuria. The subsequent developments of Japanese penetration may seem to be of political, rather than economic, significance, but they may prove to have tremendous economic repercussions.

The Occupation of the Ruhr Valley, 1923

The reparation payments which the Treaty of Versailles imposed on Germany are recognised to have been quite impossibly heavy. How much Germany actually did pay in the years immediately following the end of the War is obscured in a maze of accounts, but the total, whatever it was, did not convince France that Germany was making an honest attempt at payment. It is only fair to remember that many Frenchmen within their own lifetime had seen their country twice invaded by Germany and that France had paid in full the indemnity imposed by the victorious Germans at the end of the war of 1870. The French were determined that reparations should be paid, and when, by 1923, they were convinced that the German effort at payment was not sincere, they sought to find some action which would be so much more harmful to Germany than the payment of reparations that the Germans would prefer to pay. On the 11th of January 1923 the French occupied the Ruhr valley, with the deliberate intention, in Poincaré's own words, of "creating such embarrassment in the economic and political structure of the Reich that the execution of the treaty would be preferred to this embarrassment". They certainly succeeded in creating the embarrassment. The occupied territory contained one-fifth of the total, and one-quarter of the industrial, population of Germany; it contained 85% of her coal, 90% of

her coke, 77% of her pig-iron, and 82% of her raw steel. Between the Ruhr area and the remainder of Germany there had grown up a vast complex of closely correlated industries. Before the occupation, 75% of all the goods brought into the Ruhr valley came from, and 70% of Ruhr products found their markets in, other parts of Germany.

Under French occupation, the Ruhr area was separated from the rest of Germany by a new and arbitrary customs frontier which interfered seriously with the flow of commerce and made it extremely difficult to carry on industrial processes. This would have been a disastrous blow to German economic life in any case, even if whole-hearted endeavours to continue production had been made, but the German Government engaged in a struggle at terrific cost. Passive resistance was financed from Germany; workmen who refused to work received liberal doles; merchants whose goods were confiscated by the French were compensated; when the people took to motor transport, instead of using the railways which the French were attempting to run, three-quarters of the extra cost was paid by the German State. The approximate cost of all this, including loss of production, emergency relief, compensation for confiscation, and loss of revenue from uncollectable taxes, was officially estimated by the Germans at 4,000 million dollars up to the end of September.

In November, the German Government's support of passive resistance was costing in actual payments about 9 million dollars a day. No real

revenue had been created to meet this enormous expenditure; all the payments were financed by the printing press. The natural result was the most extraordinary collapse in currency the world has ever seen. The mark, which was 33,500 to the pound sterling at the beginning of the year, reached a maximum, probably nominal, figure of 50 million million on the 6th of November. Germany was then bordering on social disintegration while the French were obviously not improving their prospects of receiving reparations. In November, therefore, the German Government abandoned passive resistance and the French agreed to terminate the economic occupation of the Ruhr.

In 1924 a new German currency unit, the reichsmark, was established with the help and backing of a large international loan, and, by the Dawes Plan, the annual indemnity was fixed, after an easier transition period, at 2,500 million gold marks as from 1929–30. An Agent-General for Reparations was appointed, various Commissions to supervise the payment, and a Transfer Committee to turn the marks into the currencies of the creditor nations.

The significance of the Ruhr occupation is that it superimposed violent economic maladjustments on those with which the world was already struggling. Merely as one example: the British coal industry was given a short period of unsound prosperity owing to the interruption of coal mining in the Ruhr. This prosperity led to concessions of higher wages to the British miners, but the impossibility of maintaining these rates caused the friction and

discontent which had its outcome in the coal strike of 1926 and the first and only general strike in Britain. The annihilation of the value of the mark, complete except in so far as some slight revalorisation of certain debts was subsequently permitted, reduced whole classes to destitution, thus providing a recruiting ground amongst these intensely dissatisfied people for the leader of the later Nazi movement with all its economic aberrations.

Germany was not the only country to experience extreme inflation. The Russian Revolution of 1917 had placed in power a Government which aimed at State control of both production and distribution. The Government, since they contemplated a Communist system of more or less equal distribution of products by a rationing system, saw no need for money and favoured its rapid depreciation as the most convenient method for its destruction. Though the Bolshevik Government had repudiated all the debts of the former régime, there was a budget deficit for 1917 of 22,568 million roubles, which was financed to the extent of 16,403 million roubles, or 73%, by the issue of paper money. Inflation continued, until by the summer of 1921 the rouble had fallen to one eighty-thousandth part of its 1913 value, and in the State budget, in so far as it was a money budget, there was no money revenue but only expenditure covered by the issue of paper roubles. By that time, it had become apparent that money was not after all a dying economic category but a necessary accounting unit.

Without some unit in which to record costs and prices, no check could be exercised over the efficiency of the various State undertakings. It was impossible to construct balance-sheets in terms of a unit that might depreciate several per cent in the course of a single day. The New Economic Policy of 1921 reintroduced money. A new State Bank was established towards the end of that year and in 1922 was given the right to issue a new currency, the chervonetz, backed by not less than 25% in precious metals and, for the remainder, by short-term bills or readily marketable goods.

The chervonetz was stated to be equivalent to ten gold roubles. The Government, however, continued to issue paper roubles, which by 1923 had depreciated to such an extent that the peasants refused to sell their produce. In February 1924 the issue of the worthless paper roubles was stopped and the Government began to issue instead a new rouble whose total issue was definitely limited. The intention was to keep the value of the new unit equal to one-tenth of the chervonetz, and one of these new "gold" roubles was given in exchange for 50,000 million of the old Soviet roubles, or 50,000 of the 1923 issue. Thus by 1924 Russia had wiped out her old currency and started afresh with a new monetary unit.

Three other countries also experienced extreme inflation: Poland, Austria, and Hungary. When Poland was restored as an independent State, various paper currencies were circulating within her territory. The first step towards reform was the

replacement of these by the Polish mark, but the difficulties of the new Government led to continuous and rapid inflation until in January 1928 10 million marks were only worth one dollar. Further issues of marks only reduced the total value of the money, since the mark depreciated faster than could be offset by new issues. A new Government, therefore, undertook in 1924 to re-establish a stable currency. The Bank of Poland was founded and given the right to issue a new currency note, the zloty, to be backed 30% in gold or devisen and as to the remainder by the usual kind of eligible paper.[1] The Government was forbidden to borrow from the Bank beyond a maximum limit of 50 million zlotys. The rate of redemption was 1,800,000 marks for one zloty. The zloty was intended to be equal in value to a gold franc, but the exigencies of the time did not enable this value to be maintained. Though drastic efforts were made to increase taxation and to balance the budget by economies in expenditure, and a loan was obtained from the United States, the zloty continued to slip. Nevertheless the reforms of 1924 gave Poland a brief period of stability and the subsequent depreciation was relatively slight. In October 1927, with the help of further foreign loans, the zloty was devalued and stabilised at the equivalent of 11·22 U.S. cents.

The course of inflation and eventual currency reform was broadly similar in Austria and Hungary.

[1] Such as self-liquidating short-term commercial paper, adequately backed: the sort of paper that is usually considered eligible for rediscount by a Central Bank.

After a period of hyper-inflation, these countries, with the assistance of foreign international loans, organised by the League of Nations, were enabled to introduce new currencies. In December 1923 Austria established the schilling, obtainable for 10,000 paper kronen and equivalent in gold value to 14·07 U.S. cents, though redemption in gold was not resumed. Hungary in 1925 introduced the pengö, equivalent to 12,500 paper kronen or 17·49 U.S. cents. In both countries safeguards against any subsequent inflation were provided by limitation on Government borrowings from the banks of issue.

In France there was never extreme inflation. The franc, with a pre-war parity value of 19·29 U.S. cents, had declined in value to 9·3 cents by the beginning of 1920. Had the German reparation payments been fully made, the franc might have maintained that value. Indeed, in spite of the heavy expense of liquidating war contracts, rehabilitating the devastated areas, and the payment of war pensions, the franc, after a fall to 5·7 cents in November 1920, had recovered to 9·3 cents in the spring of 1922. The conditions of Government finance remained, however, very difficult and, with the collapse of the expensive occupation of the Ruhr, the depreciating franc became subject to the attacks of speculators. It was only after a strenuous struggle and repeated crises of confidence and changing Ministeries that Poincaré was able in 1926 to balance the budget for the first time since the outbreak of war. The resulting return of

confidence led to a repatriation of funds which had fled abroad for safety and permitted the stabilisation of the franc. After two years of managed stability, devaluation was legally recognised in 1928 and the gold content of the franc was changed to one-fifth of its former weight. France was back on the gold standard with a franc equivalent to 3·92 cents.

Several other countries also devalued their currency. Not all countries, however, returned to the gold standard by the act of devaluation. Great Britain decided to follow a course of price deflation in order to restore the pound to the pre-war parity. This decision, made in 1920, was influenced by the understandable desire to restore the prestige of the pound, particularly in view of the challenging position of the United States dollar. The benefits that accrued to the British from the position of London as the world's greatest financial centre were considerable and some sacrifice was justified in the endeavour to maintain the position. Furthermore, in 1919, the idea of devaluation was new and seemed to have about it a taint of dishonesty, while the effort to regain the pre-war gold parity did not appear in anticipation too strenuous. Had the great appreciation in gold, reflecting the slump in prices in 1920, been foreseen, a different decision might have been made, but, when it came, Britain, having embarked on a policy of monetary appreciation, refused to abandon it. Increased taxation, high money rates, and a decreasing note issue, while hampering industry, gradually brought the

pound nearer to the old pre-war parity of \$4·86. The unemployment among trade unionists, which had been 2·6% in 1920 and had increased through the slump in prices in 1921 to 15·3, remained at that figure for 1922 and only fell slowly. But by 1925 the Government considered it possible to return to the gold standard, and by the Act of April of that year the Bank of England was obligated to sell gold at the fixed rate of £3 17s. 10½d. an ounce, though only in the form of bars of approximately 400 ounces troy of fine gold, and export of gold was again permitted. The return of Great Britain to the gold standard is called by the Macmillan Report one of the turning points in the post-war economic history of the world.

However important and necessary these first devaluations were, the student is again reminded of the innumerable dispersed economic activities on what may be called the non-monetary side. An adequate account of these would give the economic history of the period. The world's work was still going on, subject to that shifting process to which allusion was made in our first chapter, a process activated by the desire to use existing resources in the most advantageous—or, at least, most profitable—way possible. No description of these activities can be given here, beyond a passing mention of two important developments: the improvement in the means of communication and transport due to the increased use of motor vehicles and electricity, and that comprehensive advance in industrial technique and management, largely forced on industry by

the necessities of the times, which came to be called "rationalisation" and is dealt with in the next chapter. The point we are here trying to make is that all this wide economic effort from 1921 to 1927 was handicapped by, firstly, a great fall in the world's level of prices, and, secondly, the uncertainties of the movements towards a reconstruction of currencies.

CHAPTER VI

THE LOST CHANCE

THE return of the world to the gold standard started with the German currency restoration of 1924 and was practically completed by the French legal devaluation in 1928. With the reduction of the internal debt burden and the return of stable money which the devaluations had made possible, the world entered upon a period much more favourable to the process of economic adjustment. Most countries had succeeded in establishing budgetary equilibrium, and with the fear of inflation removed and the stabilisation of the foreign exchanges apparently assured, confidence returned and was fortified by the good harvests of 1925. The improvement in the economic conditions reacted, as always, in the political sphere, and the Locarno Treaties of 1925 and the entry of Germany into the League of Nations in September 1926 did much to restore hopefulness and confidence. In this setting it is clear that the shifting and sifting process of economic adjustment had more scope to operate and met with fewer new obstructions. The progress made in production and trade during this period was remarkable, particularly in Europe, where

reconstruction was most necessary and had been more hampered.[1]

Percentage increase in 1929 *compared with* 1925

World population	4	Production of raw materials	20
Production of foodstuffs	5	Quantum of world trade	19

World economic history was dominated during the years 1921–25 by the struggle for monetary stability; for the years 1925–29 it is dominated by that struggle towards a better economic equilibrium which had been going on all the time but had now its first chance to make marked progress. Marked progress was made. It was not that these years were without their own special difficulties and set-backs: the introduction in 1924 of a system of quota control of immigration into the United States was, whether beneficial to that country or not, manifestly an obstacle to economic adjustment from the world point of view. It meant the virtual stoppage of trans-oceanic migration from Central and Eastern Europe and forced the peoples of these countries back upon their own economic resources. Great Britain was handicapped by the coal and general strikes of 1926 and Japan by the financial crisis and collapse of 1927. Germany was rebuilding her economic life only at the cost of piling up her foreign indebtedness. These were the darker spots, but the main picture was one of real progress in the re-integration of the world economic system.

[1] "By 1929 Europe had recovered the ground lost in the preceding years and the pre-war equilibrium between Europe and the rest of the World had been very largely restored." Ohlin, *Course and Phases of the World Economic Depression*, p. 17.

It is impossible to present any brief description of how in all the countries of the world, under these more favourable conditions, the process of moving labour and capital from less to more remunerative employment went on. It is an atomic process, cumulative in its results, and all that can be attempted here, beyond stressing its continuous urge, is to draw attention to two of the broader influences which accelerated the pace of adjustment, especially after the obstacles of monetary instability had been largely removed. The two influences are the reduction of costs through the rationalisation of industry, and the progress of invention leading to new industries.

Even before the War, changes in the technique of production and increasing facilities for transport were tending to favour the growth of large-scale enterprise. The unit size of the business concern in many industries was growing because of the economies of large-scale production and distribution. The pre-war large-scale enterprises, combines, and trusts, however, seem to have been actuated mainly by the motive of exploiting a monopolistic position. The idea of the rationalisation of industry is essentially a post-war growth and developed first in Germany. Germany, after the Peace Treaty, was faced by the necessity to pay large reparations and could only do so, to the extent demanded, by developing an export surplus. An export surplus would only eventuate if German goods were sold at a low enough price, and these low prices were only possible by a considerable reduction in the

costs of production. A drastic reduction in wages and the standard of living may have been the real sacrifice that Germany was called on to make as the defeated country, but the German Government were naturally averse to any such policy, which, indeed, might have been politically impossible. The only alternative, therefore, was to reduce costs other than wages. It soon became apparent that whatever might be accomplished by economies and better management of individual concerns would fall far short of what the situation demanded and that the only method likely to succeed was to deal with each industry as a whole. Nor was it only the need to increase exports that was forcing on rationalisation. The collapse of the 1920 boom had led to disastrous price cutting in many industries. The first step was to put an end to destructive competition and to establish by mutual agreement a common production and sales policy. The usual method was to agree on a restricted total production and allot a quota to each firm. Indeed, it was this rationing of production which first gave the name to the movement and only afterwards did rationing develop into rationalising. So far, this was the ordinary method of a cartel, but the output was regulated with sufficient elasticity so that fluctuations of demand could be met without delay and selling prices kept at a rate which would cover the costs of production for all and yield a reasonable profit. The distinguishing feature of rationalisation, however, is that, within this system of regulation, a comprehensive effort to lower costs of production

was aimed at in every possible way. Production was concentrated in the most suitable works which were operated as near to full capacity as possible; if necessary to attain this, obsolete and less efficient works were bought up and closed down. The most complete specialisation was attained by allocating to particular works the products for which they were most suitable; by similar arrangements all unnecessary transport was avoided. Further economies were possible by bulk purchases of materials and the concentration of the sales organisation, including advertising. At the same time great progress was made in the standardisation of products and the simplification of practice. In the United States, for example, it was possible to reduce 17,000 various types of pipes and fittings to 610 without any disadvantage to anybody, and this standardisation permitted the simplification of mechanical equipment and its adaptation to cheaper mass production. In the same country, the number of types of electric lamps, which had been 55,000 in 1900, was reduced to 342 in 1923 by the standardisation of voltages and caps. Lastly, the whole industry could pool its technical, scientific, and statistical research work.

The broad effect of rationalisation has been a considerable increase in output obtained at a less cost in human toil. In the United States from 1919 to 1927 the total industrial production increased by 30·5% though the number of workers employed in manufacturing decreased by 950,000. In Great Britain the increase in production in a group of

ten industries from 1924 to 1929–30 was 11%, while the number of workers employed fell by 8%. The process of rationalisation involves temporary unemployment, but, since it provides an equally good product at less cost, it may be regarded as setting free labour for the satisfaction of other wants, and there need be no fear that other wants will not exist. Thus, at the same time as the workers employed in manufacturing in the United States were decreasing by the 950,000 mentioned, over 760,000 additional men were taken on in the motor trades, 125,000 more in the distribution of films, and others in other industries.

At a time of displacement of labour and the need for shifting, the growth of new industries is particularly useful as an assistance to the more rapid absorption of the temporarily unemployed. In any consideration of world economic progress since the end of the Great War, the expansion of modern industries must be given due weight. Examples vary from the continued growth of the motor and artificial silk industries, and the stimulus to the cultivation of the soya bean and of citrus fruits, to the coming of newer industries such as the construction of aircraft, the radio, the film industry in all its ramifications, the extended use of household electrical appliances, and the more recent triumphs of industrial chemistry in the use of plastics.

By 1927 world economic recovery seemed to be assured and the standard of living in the United States was higher than any area of comparable size had ever previously experienced. Nor did

there seem to be any reason why economic progress should stop; a new millennium of prosperity and the more abundant life appeared to be dawning. The technological reasons for poverty were vanishing. Under these circumstances, another World Economic Conference was called at Geneva in May 1927 with the general idea of consolidating the economic recovery and ensuring its continuance. It has been said[1] that "the whole work of the Conference was dominated by the idea of rationalisation. The resolutions on international trade were inspired by the ideal of the rational distribution of work between nations. The resolutions on agriculture placed in the foreground the idea of the rational organisation of the relations between agricultural producers and industrial consumers. Finally, the various industrial questions were studied from the standpoint of rationalisation, particularly the question of international industrial agreements". In a series of resolutions, the Conference stated that it considered that one of the principal means of increasing output, improving conditions of labour, and reducing costs of production, is to be found in the rational organisation of production and distribution. It considered that such rationalisation aims simultaneously: (1) at securing the maximum efficiency of labour with the minimum of effort; (2) at facilitating by a reduction in the variety of patterns (where such variety offers no obvious advantage) the design, manufacture, use and

[1] International Labour Office, *The Social Aspects of Rationalisation*, p. 5.

replacement of standardised parts; (3) at avoiding waste of raw materials and power; (4) at simplifying the distribution of goods; (5) at avoiding in distribution unnecessary transport, burdensome financial charges, and the useless interposition of middlemen. And the Conference stated that the judicious and constant application of rationalisation was calculated to secure: (1) to the community, greater stability and a higher standard in the conditions of life; (2) to the consumer, lower prices and goods more carefully adapted to general requirements; (3) to the various classes of producers, higher and steadier remuneration to be equitably distributed among them.

But, if the Conference stressed the importance and promise of rationalisation, it is equally true that it was even more strongly convinced of the necessity for freer international trade, both because of the direct advantages to be obtained and because the regained stability of the exchanges, now that the world was back on the gold standard, could hardly be maintained without a continuous flow of international commerce. Indeed the Conference had even more serious reasons for its advocacy. "We are concerned," it stated, "not only with the prosperity but with the peace of the world. It is our unanimous conviction that the maintenance of world peace depends largely upon the principles on which the economic policies of nations are formed and executed, that the Governments and peoples of all countries should constantly take counsel together as to this aspect of the economic problem;

and that we should look forward to the establishment of a recognised body of principles designed to eliminate the economic difficulties which cause friction and misunderstanding. Economic conflicts and divergence of economic interest are perhaps the most serious and the most permanent of all the dangers which are likely to threaten the peace of the world. No machinery for the settlement of international disputes can be relied upon to maintain peace if the economic policies of the world so develop as to create not only deep divergencies of economic interest between different masses of the world's population but a sense of intolerable injury and injustice. *No task is more urgent or more vital* than that of securing agreement on certain principles of policy which are necessary in the interests of future peace." "As the starting point and angle of approach to the different problems, the Conference, as an international conference, has felt bound to assume that international trade is itself to be desired; that the exchange of products and services between persons either of the same country or of different countries is normally to the advantage of both parties; that the greater the range of exchange of different products between those who by their resources and capacities are best fitted to produce them, the greater is the general economic advantage; and that international exchange of products best and most economically produced in different countries should therefore be regarded as the normal rule."

For these reasons, therefore, the main conclusion

of the Conference in the field of commercial policy was that the time had come to put a stop to the growth of Customs tariffs, and to reverse the direction of the movement by an effort made along three lines, viz. (1) Individual action by States with regard to their own tariffs; (2) Bilateral action through the conclusion of suitable commercial treaties; (3) Collective action, by means of an enquiry, with a view to encouraging the expansion of international trade on an equitable basis by removing or lowering the barriers to international trade which are set up by excessive Customs tariffs. It also recommended that commercial treaties should contain the unconditional most-favoured-nation clause in its broadest and most liberal form.

The President of the Conference in his concluding speech remarked: "If I had to sum up in a few words the most striking feature of the Conference, I could not do better than quote a sentence from the Report of the Commerce Commission: 'In spite of the variety of the questions raised, the diversity of theories, and the legitimate national sentiments of all those who took part in the discussions, one important and extremely encouraging fact has emerged; and, having emerged, has become increasingly manifest as the work has advanced. This fact is the unanimous desire of the members of the Conference to make sure that this Conference shall, in some way, mark the beginning of a new era, during which international commerce will successively overcome all obstacles in its path that unduly hamper it and resume that general

upward movement which is at once a sign of the world's economic health and the necessary condition for the development of civilisation.'"

Did the new era of increasing international trade begin? It did not. The opportunity to revive world prosperity was lost. How appalled this Conference would have been could they have foreseen that within six years international trade, far from resuming its upward trend, was to lose one-quarter of its physical volume and two-thirds of its monetary value![1]

For a short time the exhortations of the Geneva Conference had some slight effect. There was a pause in the growth of higher tariffs. In 1927 France and Germany signed their first commercial treaty since the War, granting mutual concessions. Germany was enabled to compete in the French market on level terms with other countries, though this was achieved not solely by lowering the tariff on German goods; the minimum rates granted to other countries were raised. In 1928 an International Convention was negotiated for the abolition of import and export prohibitions and restrictions. It was to come into force when eighteen countries had ratified it. Seventeen had done so by June 1930, but the Convention then lapsed on Poland's refusal to ratify. In 1930 an agreement was signed at Oslo whereby the Scandinavian countries, Belgium, and the Netherlands established a procedure of notification among their countries before any tariff changes would be made. It is convenient to

[1] See diagram on page 118.

mention here the later Ouchy Convention between Belgium, the Netherlands and Luxembourg which, signed in 1932, provided for a reduction of restrictions upon trade between these countries. The Convention was open to the adhesion of all States on a footing of complete equality, and the World Economic Survey for that year regarded it as the first definite and practical move towards freer trade and said it was clear that it might develop into a collective treaty for the reduction of tariff duties and the removal of other trade restrictions as recommended by the Geneva Conference.[1] The Ouchy Convention, however, was wrecked by the refusal of the British Government to abandon its most-favoured-nation treaty rights.

Another event of these years which held out hopes of easing economic strain was the substitution for the Dawes Plan of the Young Plan. The payment of German reparations under the former plan had only proved possible by the increase in German borrowings from abroad, mostly from the United States. Since this was clearly no ultimate solution of indebtedness—and, moreover, American lending was ceasing in 1928—a new plan was adopted in 1929 which scaled down the debt payments and, by abolishing all the Reparation Commissions in Germany, restored fiscal autonomy to that country. In place of the Dawes annual payment of 2,500 million reichsmarks for an indefinite period, the Young Plan arranged for an average annual payment of rather more than 2,000 million reichsmarks

[1] Op. cit., p. 309.

for thirty-seven years, after which continuance, on a reduced scale, depended on the unwillingness of the United States to forgo the outstanding inter-allied war debts. The payments were divided into 660 million reichsmarks non-postponable, mostly paid to France, and the remainder which could be postponed in emergencies under a specified procedure. Germany was responsible for the transfer into foreign currencies and no provision was made for any adjustments according to the fluctuations in the value of gold. The office of the Agent-General for Reparations being abolished, some agency had to be provided to handle the accountancy, and a Bank for International Settlements was established at Basle. In this indirect way, the world became possessed of an institution formerly lacking: a World Bank to exercise in relation to the Central Banks similar functions to those which they exercised in relation to the commercial banks of their own countries. If the Bank for International Settlements held a part of the reserves of Central Banks, international indebtedness could be settled by clearings with the Basle bank and the use of gold would become unnecessary. Ultimately the Bank may develop a collective control over world credit, but for various reasons, of which national spirit and suspicions are perhaps the chief, this development will be slow. The Government of the Bank was deliberately kept out of the direct control of politics by placing the apppointment of the President in the hands of the Directors and the election of the directors in the hands of the Governors

of the Central Banks. Hitherto the greatest usefulness of the Bank has been in providing a regular meeting-place for consultation and co-operation between the heads of the Central Banks of the world. It is regrettable that the United States would not allow the Governor of the Federal Reserve Board to act. There seems nothing to be lost and much to be gained by the co-operation of the United States in the achievement of the purposes of such an institution and the knowledge which the American representatives would have acquired might have saved their country from some of the errors of their subsequent monetary policies. The Bank, unable to obtain the personal support of the Federal Reserve authorities, did the best it could by providing for representation from unofficial American financial institutions.

For a brief period the Report of the Geneva Conference of 1927 did have some effect in checking the growth of higher tariffs and even in winning some minor successes towards breaking down the barriers to international trade. For a few months the forces making for higher or lower tariff policies seem to have been evenly poised.[1] Had some great commercial country taken the lead by adopting a liberal policy of reduced tariff rates, the world might have followed this lead, the hopes of the Geneva Conference might have been fulfilled, and many of the subsequent economic calamities have been averted. The lead could not come from Great Britain since, at that time, she was, except for the

[1] League of Nations, *World Economic Survey* 1931–32, p. 279.

relatively unimportant duties under the Safeguarding of Industries Act and the old revenue duties, a free trade country. The United States, who were in an admirable position to give such a lead, not merely failed to do so but swung the world into the pernicious path of ever higher and wider tariffs by the example and effect of their new tariff of 1930. The result was that the early victories of the Geneva-stimulated forces making for freer trade were turned into a complete rout and the world entered on a course that led by 1933 to a reduction of international trade to only one-third of its 1929 value, accompanied by the growth of unemployment among able-bodied workers to the unprecedented and tremendous figure of 30 millions. The Hawley-Smoot tariff of 1930 was not the sole cause of this catastrophe. The fall in world prices after 1929, dealt with in the next chapter, was another cause, and, even so far as the battle for freer trade was concerned, there were two other important contributing causes: the need for protection for European agricultural producers and the sudden cessation of foreign loans.

The position of agricultural producers in Europe had been steadily worsening. The War had greatly stimulated agricultural production in North America, Argentina, and Australia. Moreover, the areas in these countries were made more productive by the mechanisation of agriculture and the introduction of better varieties of seed-grain. Canada's wheat production rose from 232 million bushels in 1913 to 550 million bushels in 1928; Argentina's from

169 million in 1913–14 to 239 million in 1927–28. This illustrates the weight of the oversea competition the European producer had to face. Furthermore, the migration of European peasants had been greatly restricted, since the introduction of the quota policy by the United States in 1924, and many European countries, forced to provide for their people at home, had adopted an agrarian policy of dividing large landed estates into small farm holdings. These small holdings were not suitable for mechanised farming even had the farmers possessed the necessary capital to introduce such methods. The farmers were, indeed, largely over-burdened with debt, partly as a result from the fall in prices after 1920. In addition, the farmer was hit by the relatively rising costs of living due to the increase of tariffs and taxes on much that he had to buy. If the European countries meant to keep these agricultural workers on the land, or, indeed, to enable them to maintain themselves at all, help had to be given. Whatever arguments might be brought forward in favour of freer trade, protection to the agriculturalist seemed unavoidably necessary in the interests of social stability. Consequently, Germany, as soon as she was free to do so, imposed in 1925 a higher tariff on food imports. In a few years, the obstacles to food importation into Germany were largely prohibitive. The closing of the German market to other countries increased the difficulties there, and step by step they also set up more and more barriers to imports. Not merely were tariffs raised, but milling regulations and import licences

were introduced, and eventually the rigid barrier of the quota. Even Great Britain passed the Wheat Act of 1932 and imposed a duty of 2*s.* per qr. on foreign wheat.

The period of great prosperity on which the United States entered after 1923 was marked by a great increase in their loans to foreign countries, especially Germany and South America. In 1922 the foreign investments of the people of the United States, exclusive of the war debts due to the Treasury, had been estimated at 1·9 billion dollars; by the end of 1930 this figure had risen to 15·5 billions. It was these loans which had enabled Germany to reconstruct her economic life and to pay the reparation annuities. By 1928 the great investment boom[1] in the United States was well under way with the result that the funds of the American people were used for gambling at home rather than for investment abroad. Indeed, the Wall Street boom attracted money from all over the world. From about the summer of 1928, therefore, the volume of capital available in the United States for foreign investment began to shrink and the export of United States capital in 1929 was only 206 million dollars compared to 1,099 million dollars in the previous year. This sudden cessation of lending was disastrous to debtor countries which had geared their economies to an inflow of borrowed capital and, with the chief source cut off, were at once in difficulties over their balances of payments. In their endeavour to meet their obligations, they

[1] See next chapter.

might have striven to increase their exports by reducing wages, costs, and the standard of living. This, besides being unpopular, was not likely to be successful in the face of the general reluctance of countries to receive more imports and especially goods which would have appeared to them to have been dumped on them by underpaid labour; the effort to increase exports would probably have been met by increased tariff duties. Accordingly, the debtor countries had to try the other road of decreasing their imports: hence the choking growth of higher tariffs, quotas, licences, and eventually strict exchange control. What are imports to one country are exports to another, and thus international trade withered.

The Hawley-Smoot tariff was introduced into the United States Congress before the Wall Street crash of 1929 but the Act was not signed by President Hoover until June 1930. The new tariff, formulated after over a year's sordid haggling in Congress, was higher than ever; the duties on some 900 different items were increased, affecting imports from nearly every country in the world. It reached the highest protective level of any American tariff law ever passed, with an average rate about 20% above that of the Fordney-McCumber tariff of 1922.

If the first of the major post-war economic catastrophes was the great slump in prices which started in 1920, and the second was the French occupation of the Ruhr in 1923, the third, and the least excusable, was the Hawley-Smoot tariff. It

was said, by a political opponent of the Government, that the motivating principle behind the tariff was the simple determination of special groups of industrialists to cash in on their previous year's campaign contributions. It might be better to listen to less biased critics: "No less than 36 countries", says Mr. Peter Molyneux, an American writer, "made diplomatic representations through the American Department of State against proposed increases in the bill, and a protest signed by more than a thousand American economists, representing 46 States and 179 Universities, was filed with Congress and with the President. . . . All this was of no avail, however. The Hawley-Smoot Tariff Bill was passed by both Houses of Congress at the behest of a narrow-minded and ignorant lobby and President Hoover signed it in due course. By that Act, whatever chance existed to stem the operation of the forces of disintegration which had already been set in motion was destroyed. The world depression was started on its way at top speed. Promptly more than forty other countries sought to adjust themselves to the situation by setting up barriers against American goods. They had no choice. Most of them had sought to avoid the necessity of taking such a course by protesting."[1] Mr. Cordell Hull, the Secretary of State in the next Government, admitted, "through that ill-starred action we helped to set in motion a vicious spiral of retaliation and counter-retaliation and to start a race for a forcible contraction of international

[1] *International Conciliation*, June, 1935, p. 315.

trade on a stupendous scale".[1] "Following the passage of the Act", wrote R. B. Fosdick in February, 1931, "there came from every corner of the world a volume of angry protest and retaliation which has scarcely diminished to this day. The Act was a blow struck by one nation at the economic stability of sixty nations. It was the blind, desperate effort of a great country to hang on to the top of the ladder by kicking at every other country. Take the case of Switzerland, for example. The Swiss Republic is to a large extent a nation of watchmakers. She has no natural resources; she imports all her raw materials. She has been shipping to the United States approximately $11,000,000 worth of watches and watch movements every year. Our new tariff bill closed the doors of many of her factories. A handful of men, sitting round a table in Washington in an atmosphere heavy with ignorance and cigar smoke, crippled the chief industry of a country three thousand miles away. This is not world order. It is anarchy."[2] "If I were to summarise", wrote Mr. G. E. Putnam, "the consequences of our post-war tariff policy, I should say that our refusal to take goods in payment of the obligations due us upset the monetary systems of almost the entire world, gave rise to prohibitive trade barriers, reduced world trade to a fraction of its former proportions, depressed world prices, and was directly responsible for the aggravated character of the present depression. We were not the only offenders,

[1] *International Conciliation*, October 1936, p. 458.
[2] id., Feb. 1931, p. 77.

of course, but we were the most conspicuous violators of sound principles."[1]

With these home criticisms we may leave the Hawley-Smoot tariff. It is sufficient to say that it was the prime cause of the loss of the Geneva battle for freer trade.

[1] *International Economic Relations*, the University of Minnesota Press, 1934, p. 253.

CHAPTER VII

THE SECOND SLUMP IN PRICES, 1929-33

THE period of general world prosperity which became evident about 1925 as a result of the cumulative effects of efforts at economic reconstruction, included among which was the restoration of the gold standard, came to an abrupt end in the autumn of 1929. On the 29th of October of that year there was a tremendous crash on the New York Stock Exchange and thenceafter a swift recession in prices which spread throughout the world: the price-structure disintegrated and collapsed and with it went all the gains of the first ten years of post-war reconstruction. The whole economic organisation of the world was disrupted by the consequent growth of serious maladjustments, since prices did not fall equally in all industries or in all areas, and the debt burden became again intolerable. The Wall Street boom and crash were not the sole causes of this world slump in prices. Other elements of economic instability were gathering force in the world as a result of the failure to free international trade from its many obstacles. Indeed, it may be argued that the mass-speculation in the United States would not have developed had freer importation, with its tendency to lower prices, been permitted. Moreover, as

was mentioned in the last chapter, this speculative boom in the United States had caused a cessation of American loans to foreign countries and had drawn funds from many other centres, so that debtor countries were in difficulties even before the crash. Nevertheless, however precarious world prosperity was in 1929, there seems good reason to suppose that the dramatic collapse on the New York Stock Exchange was the chief cause of the subsequent slide in prices.

The Crash in the New York Stock Market, 1929

The growth of the great American investment boom was the outcome of a period of increased production and real prosperity. The fall in prices in the United States in 1920 and 1921, the protectionist trade policy, and the war debt receipts, had together resulted in a great flow of gold into that country. On the basis of this gold, there was an enormous extension of credit. The loans and investments of all banks in the United States rose from 39,956 million dollars on 30 June 1922 to 53,723 millions on 30 June 1927. This increase of more than 13,750 million dollars might have been expected to lead to an increase in commodity prices, but the increased production of goods, largely due to methods of rationalisation in industry and the mass production of standardised articles, kept pace; the price level showed considerable stability and was actually slightly lower in June 1927 than in June 1922. With 13,750 million more dollars in the country and the same price level, the nation

was quite definitely much better off and the standard of living was noticeably higher. People had been accustomed to regard a sharply rising price level as the sign of the development of unsound boom conditions. The price level, however, was not rising, and it was this steadiness which induced many to believe that a new era of wonderful prosperity had dawned. In their endeavours to discount the future, speculators avidly bid up all common stocks: the higher the market quotations went, the more justified their action appeared. Speculation ran riot until people were borrowing money at 10% to buy stocks which would only yield 2% on the purchase price. The Federal Reserve authorities, alive to the danger, were anxious to check the speculation but held on to cheap money during 1927, partly in deference to the request of the European central bankers who feared higher money rates in New York would attract more of their gold and possibly make the maintenance of the gold standard, so recently re-established, impossible. Another motive may have been the desire not to check the boom before the autumn elections. When, early in 1928, the Federal Reserve Board started to tighten money rates, speculation had gathered so great a momentum that it had gone beyond control. The speculators, who by this time were nation-wide, disregarding signs of business recession and several temporary but ominous breaks in the market,[1] went on buying. During the twenty

[1] See Day, *Introduction to the Money and Banking System of the United States*, Part II, Chapter VII.

months ending September 1929, the value of all shares listed on the New York Stock Exchange increased by over 51,000 million dollars! In October of that year the speculators found that the securities, bought largely on borrowed money, were no longer rising. On Thursday the 29th of that month a hurricane of liquidation hit the market and by the Tuesday of the following week the market value of 240 representative securities had declined by 15,984 million dollars. Another estimate is that between 3 September and 13 November, the market value of all shares listed on the New York Stock Exchange dropped by 30,000 million dollars, a sum about equal to the total reparations payment required of Germany under the Versailles Treaty.

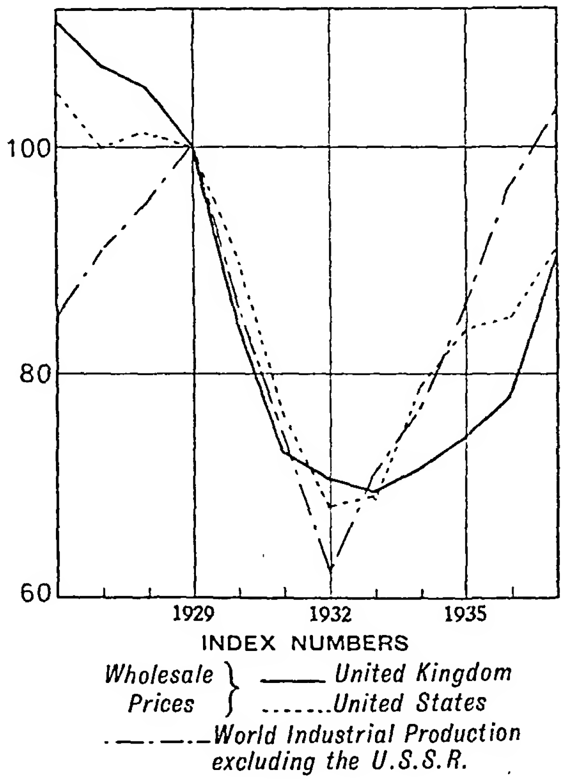
The following index numbers illustrate the extent of the deflation:

1926=100	September 1929, before the crash	Date and lowest point of the fall
Security prices:		
421 Ordinary shares	225	June 1932, 34
60 Bonds	94·8	June 1932, 72·8
Wholesale price level	98	Spring 1933, 60

Industrial production and factory employment have an index number based on 1923-25 as 100; the index numbers in both cases reached a peak before the crash, a fact which ought to have been sufficient warning. Industrial production reached its peak of 127 in June 1929; factory employment, with its usual time lag, reached its peak of 103 (the lower

figure being an interesting sign of the increased industrial efficiency) in August. Industrial production touched bottom in July 1932 at 58; factory employment in March 1933 at 59. The aggregate

PRICE LEVELS (2)



net profits, less deficits, of 315 industrial corporations were in 1931 70% below the profits of 1929.

The fall in world prices,[1] of which there had been

[1] The actual extent to which wholesale commodity prices fell from the peaks of 1929 up to the turn in March 1933 varied considerably from country to country, but averaged about 40% in terms of gold currencies. The raw materials and agricultural products which enter largely into international trade

some evidence before the Wall Street crash, became precipitous and was especially felt by debtor agricultural countries. By 1930 South America, Australia and New Zealand were off the gold standard. Then in 1931 came another great calamity, the extraordinary credit crisis in Europe.

The Credit Crisis in Europe, 1931

Most of the European countries had been attempting to reconstruct their economic life with borrowed capital. How many of them might have eventually restored their productivity sufficiently to repay the borrowed funds is difficult to estimate. However, they suddenly found themselves unable to obtain loans, firstly because of the attraction of the Wall Street gamble where call-money rates had at times touched 20%, and secondly because, after the crash, the people of the United States were less able to lend and, conditions in Europe having greatly deteriorated, less willing. The European debtor countries had, therefore, to endeavour not merely to carry on without the accustomed influx of capital but also to pay the interest on the accumulated debt. In their endeavours to acquire foreign funds to do this, they, as was mentioned in the last chapter, were driven to place additional restrictions on importation with the result that, as each began to close its markets against all, the difficulties became even acuter.

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fell on the average about 50%. League of Nations, *World Economic Survey* 1932–33, p. 43.

The crisis developed first in Austria, a country which had been reduced by the Peace Treaty to an impossible economic position: a great metropolis shorn of its surrounding territory and opposed by high tariff barriers on its new restricted frontiers. For a time the increasing difficulties of Austrian economic life were supported by help from the Boden Creditanstalt, historically the most important banking institution in Central and Eastern Europe. In May 1931 this Viennese bank was found to be insolvent. The seriousness of the situation was at once realised. A collapse of Austrian credit would involve many other countries and would further fan the growing feeling of panic. This was particularly dangerous since so much of the international lending had dwindled to short-term loans which might be withdrawn at any moment. To forestall panic, the Austrian Government guaranteed the deposits of the Creditanstalt and appealed for foreign help. The French Government was not prepared to assist without a promise that the proposal for an Austro-German Customs Union, brought forward in March, should be dropped, and the delay might have been disastrous had not the Bank of England promptly advanced 150 million schillings while at the same time 100 million schillings were loaned by the Bank for International Settlements to the National Bank of Austria. Foreign creditors were induced to agree not to withdraw their loans for a period of two years. This was the first of the so-called Standstill Agreements of which there were later many other cases. This saved the situation

in Austria for the moment, but confidence in the financial soundness of Europe was thoroughly shaken. The great fall in prices was taking place and the burden of debt was increasing. As a result, the Young Plan, which had been intended to give relief to Germany, failed entirely in its purpose. A run began on the Reichsbank and the situation was looking desperate when a belated offer from the United States to grant a year's moratorium on war debts if the allied creditors would give a similar moratorium on German reparations roused a little hope. The acceptance of the Hoover moratorium was unfortunately delayed by French hesitance, and when it came into effect on 6 July, it was too late to hold back the panic. On 13 July the great Danat Bank had to close its doors in spite of the German Government's guarantee of its liabilities. On 19 August a Standstill Agreement was negotiated for German debts to foreigners.

Great Britain abandons the Gold Standard, September 1931

The help which the British, in an attempt to save the situation, had given to Austria, Germany, and other eastern European countries, had resulted in a large amount of their short-term loans becoming frozen. It is true that the Macmillan Committee had reported in July that "Great Britain's position as a creditor country remains immensely strong". Nevertheless, her income from shipping services had fallen with the great decline in international

trade, her income from overseas investments had been cut by numerous defaults with more threatening to come, her wage level had not been reduced with the falling cost of living, and imports had not fallen as much as exports. Moreover, the May Report, published on 31 July, had brought to the attention of more than the British the probability of a deficit of some £120,000,000 in the public finances, due largely to the insolvency of the Unemployed Benefit Fund.

The first drain of funds from London was caused by foreign creditors who required the money to meet their own difficulties at home, but the resulting weakness of sterling occasioned uneasiness. Speculation against sterling began. A weak currency hanging on to the gold standard with difficulty is always a temptation to speculators. If they sell it short forward, they can hardly lose, since under no circumstances is it going to rise above the gold value. On the other hand, if it eventually is forced to abandon the gold standard, they may make considerable profits. By July the drain on the gold reserves had become so great that the Bank of England jumped its discount rate from $2\frac{1}{2}$ to $4\frac{1}{2}$%. This was the traditional weapon of defence, but it broke. The higher rate, instead of attracting funds to London, was regarded as a sign of distress. Then came the May Report and the increase of the fiduciary issue[1] of the Bank of England. The flight of foreign funds from London accelerated and it was necessary

[1] The fiduciary issue, that part of the issue which is not backed by gold, was increased by £15,000,000 in August.

for the Bank of England to borrow £50,000,000, half in francs from the Bank of France and half in dollars from the Federal Reserve Bank of New York. Still the drain continued and in the two months following 20 July over £200,000,000 were withdrawn from the London money market. The Bank of England could not obtain further foreign credits; additional help would only be given to the British Government itself and only on conditions of drastic reform of the public finances. The Labour Government in power were unable to agree and the outcome was the formation of a "National" Government with Ramsay MacDonald continuing as Prime Minister but largely supported by the Conservative Party. In order to induce the country to acquiesce in the necessary retrenchments in Government expenditure, including both pay in the national services and in unemployment benefit, it was necessary to arouse the people to the dangers of the situation. Unfortunately, the more the Government attempted to frighten the British elector, the more they scared the foreign holder of British funds. The Treasury obtained a further foreign credit of £80,000,000, again half in francs and half in dollars, from France and the United States, but the drain continued. The British elector, phlegmatic as ever, had not been so thoroughly frightened as to make the Government a really national one; in particular, there was still a strong Labour Opposition and a group of dissident Liberals. But the foreign holder of British funds was thoroughly scared. On the 15 September the cut in naval

pay led, probably through lack of explanation, to a protest from some sailors in the fleet at Invergordon, which was written up in the Continental Press as a "mutiny". This was the last straw; the withdrawal of short-term funds in the following half-week rose to £43,000,000 and on Monday, 21 September, the Bank of England's obligation to sell gold was suspended. Great Britain had left the gold standard. The shock to the financial world was profound. A drain of gold from the United States at once set in and during the next six weeks 730 million dollars of gold were withdrawn from circulation in that country, though 415 million dollars remained earmarked but not exported. The United States, however, had enough surplus gold to withstand the strain.

The departure of Great Britain from the gold standard was followed by the rest of the world with the exception of a small but important group forming the gold bloc. By the end of 1932, 35 countries were off the gold standard and many others were exercising exchange control. The United States, France, Switzerland, Holland, and Belgium were the only important countries left on gold. The world's monetary mechanism had collapsed. The gold exchange standard, advocated by the Genoa Conference, had received a death-blow. Many people, unwilling to trust their money in any country's currency, started to hoard gold.

With the fall in prices after 1929 and the British leading the world off the gold standard in 1931, there came a period of acute depression and economic

chaos. Such a period begets Government action and attempts at reconstruction and control. There developed a bewildering maze of economic effects on the political situation and the reaction of political interference on economic conditions. To attempt to unravel all this in a brief outline is impossible. One is tempted to pass on to the World Economic Conference in London in June 1933 and to look back from that standpoint, but some events in the intervening years are too important to pass over: the Japanese invasion of Manchuria, the British abandonment of free trade, the growth of economic nationalism, Lausanne, the rise of Hitler, and the banking crisis in the United States.

The Japanese Invasion of Manchuria

The depression following the collapse of prices had hit Japan severely. Ninety per cent of her raw silk exports had usually been taken by the United States, but it is a luxury product and the demand from that country fell off to such an extent that in 1930 the price had dropped to only one-fifth of its pre-depression price. The national problem of maintaining the standard of living of an increasing population became particularly acute at a time which happened to coincide with Europe's preoccupation with the great credit crisis. The opportunity was too good to miss and the Japanese invaded Manchuria. They had already obtained special rights in that country which had occasioned a steadily increasing tension between them and the Chinese. An alleged

explosion on the railway on the night of 18 September 1931 provided the Japanese with an excuse; their armies quickly over-ran the country and in a few months they were able to set up a puppet kingdom, Manchukuo, which declared its independence of China on 18 February 1932. This attack on northern China was not so much for the sake of acquiring territory, though it had its economic and strategic importance, as to put pressure on the Nanking Government to stop the popular boycott of Japanese goods and generally to collaborate with the Japanese in the economic development of China. Since they failed to achieve these latter objects, the decision was made to continue the pressure. There were further advances into northern China without any effect in bringing the Chinese Central Government to agree to the Japanese programme and policy and in July 1937 the Japanese landed at Shanghai and commenced an invasion of central China. Nanking, Hankow, and Canton have been captured, but the outcome of the adventure, at the time of writing, is obscure. It is clear, however, that the Japanese action has had very great influence on the economic fortunes of both countries and may have very far-reaching results.

Great Britain Abandons Free Trade

In Great Britain, the National Government, which took office on 24 August 1931 in order to save the pound, had been obliged to abandon the struggle. The link with gold was snapped on

21 September and the immediate concern was how far would the pound depreciate. It might have been supposed that British prices would rise and the cost of living increase, but, as the event turned out, it was gold prices which fell and sterling prices remained fairly steady. In order to support the pound, a temporary import duty of 50% on a long list of commodities was immediately imposed, and in July 1932 a Treasury ban was imposed against British loans to foreigners. There had been for some time a large element in the Conservative Party desirous of abandoning free trade, but their efforts had been defeated at the polls. The opportunity of a large parliamentary majority and the confusion of public opinion gave the protectionists their chance. The fall in the exchange rate of the pound would itself have tended to check imports and encourage exports, but this consideration was pushed aside. From 1 March 1932, by the Import Duties Act, Great Britain abandoned her ninety-year-old policy of free trade and joined the protectionist world. The range of duties ran from 10% to 33⅓%, the main grouping being at first at the lower rates. The commodities covered by the new duties were about 40% of the total imports into Britain.

New Protectionist Devices

The Hawley-Smoot tariff[1] had started the world on a scramble to build ever higher protective tariffs;

[1] See page 86.

the hauling down of the banner of free trade by Great Britain accelerated the scramble to a veritable panic. General tariff increases were made by country after country, and in some of them made again and again. Not only that, but more drastic measures of stopping imports were introduced, such as the prohibition of imports except under licence or the definite limitation of imports to a specified quota. By the spring of 1933 France had quotas applying to over 12,000 tariff items equivalent to about one-third of the total value of imports. Many countries introduced exchange control whereby importers were unable to offer money for foreign goods unless the Government, which had impounded all the foreign currency receipts from exports, was willing to provide the foreign funds. "By the middle of 1932," says the League of Nations *World Economic Survey*,[1] "it was obvious that the international trading mechanism was in real danger of being smashed as completely as the international monetary system had been." One result of these developments was that, the various national markets being cut off from one another, prices varied from country to country in an abnormal and ridiculous way. Thus, butter might cost twice as much in France, and sugar three times as much in Germany, as in Denmark; the price of Cuban sugar, free of duty, fell in New York 58% during the three years 1930–32 while, during the same period, it rose 20% in Germany and fell 12% in Poland.[2]

[1] Op. cit., 1932–33, p. 17.
[2] The retail price of sugar per kilogramme in 1935–36 was

Meanwhile, Russia, voluntarily isolated from the full effects of the economic developments in the rest of the world, was carrying out her Five-Year Plan started in 1928. The plan was broadly one of rapid industrialisation, collectivist large-scale agriculture, and a State monopoly of foreign trade, and it attained a considerable degree of success.

The Growth of Economic Nationalism

It is possible here to bring four strands together: the need for State encouragement and control of the rationalisation movement: the growth of State interference with foreign trade partly as a result of the constant damage to a country's economic life by hostile tariffs or dumping, and partly as a measure of currency support: the fear of war or the need for a credit balance which led to attempts at the greatest possible national self-sufficiency: and the influence of the Russian experiment; all combined to favour the growth of what has been called "economic nationalism". This term has two shades of meaning; on the one hand, it stresses the advantages of national self-sufficiency both as giving greater security and greater possibilities of control, and, on the other, it stresses the advantages of, and the need for, the control of all aspects of economic activity in the common interests of the nation. The latter aspect has been familiar

equivalent to 4½ pence in Sweden and Switzerland, but to 15 pence in Germany and nearly 16 pence in Italy.

in recent years in the movement for Economic Planning. There is already a large literature on the subject which it is impossible to review here. All that can briefly be said is that economic planning has been carried furthest in the States which are governed by dictators and that frequently the end pursued is less economic welfare than national security or social reform. The economic planner usually seriously underrates the difficulties of a planned economy in all its ramifications since he generally concentrates on the possibility of producing enough standardised necessities for all and seldom tackles the real economic problem of the optimum use of all available sources of production. The abolition of the profit motive and the price mechanism would leave production at the arbitrary whim of a small group in power who could not possibly make all the innumerable decisions that are daily made by the business world. These are controversial matters, but it seems undeniable that continuous State encroachments and curbs on private enterprise, without the State being able to take over all production, have increasingly caused dislocation, maladjustment and a lack of business confidence.

The Lausanne Agreement, 1932

The fall in prices since 1929 had made the Young Plan as heavy a burden on Germany as the Dawes Plan had been, while the cessation of foreign lending had led to the credit crisis of 1931. Mani-

festly, some further effort at amelioration was essential. The urgency of the situation was demonstrated by the resignation of the Chancellor, Dr. Brüning, on 30 May 1932. The electoral successes of the National Socialists, led by Hitler and supported largely by the people who had been disinherited by the hyper-inflation, scared the creditor powers and a hurried conference was held at Lausanne. This was a conference of political leaders and not, as the former reparation conferences had been, of experts. The Lausanne Agreement, signed on 9 July 1932, in effect terminated Germany's reparation payments. Germany was to pay nothing for three years, and after that she might be asked, if economic conditions were favourable, to try and raise money for payments by the issue of bonds limited to 3,000 million gold marks. Whatever amount of these bonds it had been impossible after fifteen years to issue was to be cancelled. The ratification of the Agreement, however, depended upon some response from the United States in the matter of war debts. The least that was expected was a continuation of the Hoover moratorium pending negotiations for a final settlement. The next payments of the war debts were due on 15 December 1932. Unfortunately, the primary elections for a new President were taking place that autumn and neither party was willing to incur the supposed odium of cancelling the debts or even extending the moratorium in the face of the acute business depression and growing unemployment. In vain intelligent opinion urged some response to

Lausanne. "While the problems dealt with at Lausanne," wrote Nicholas Murray Butler, "are in name European problems, they are in fact world problems and the return to prosperity in the United States waits upon the co-operation of American public opinion and American governmental action. Europe has now done all it can do to restore prosperity in the United States without effective and prompt American co-operation. The next step must be taken by Washington and to delay it on any pretext whatever—particularly on the ignoble pretext of partisan political advantage—is to do continuing and grievous injury to the American people."[1] But the moratorium was not renewed; not even when President Roosevelt was safely in office was any action taken to reduce or cancel the debts. Lausanne was never ratified, and lapsed. On 31 January 1933 Hitler became Chancellor of Germany and in October Germany withdrew from the League of Nations. Great Britain paid the December 1932 instalments of the American debt in full in gold, but France, Poland, Belgium, Estonia, and Hungary defaulted. Twice later Great Britain made a token payment, but, after that, war debts and reparations were left unsettled and unpaid. The United States would scarcely have lost anything by responding to the Lausanne invitation; the World might have gained very much.[2]

[1] *New York Times*, 18 July 1932.

[2] Two other political events which were to have economic repercussions in widely separated fields were the outbreak

The Banking Crisis in the United States, March, 1933

The business recession in the United States, following the Wall Street crash, had been severe. The buoyant optimism, which the previous period of unprecedented prosperity had generated, was suddenly shattered. The blow came as a stunning shock to the whole nation. Commercial credit and bank credit were evaporating and President Hoover attempted to support the business world by placing Government credit behind them. The Reconstruction Finance Corporation was set up in January 1932 to lend money to banks and railways and by July further assistance was given under the Glass-Steagall Act, the Emergency Relief and Construction Act, and the Home Loan Banks Act. Conditions, however, steadily worsened in the autumn. The lack of response to Lausanne had its depressing influence, but in addition the "lame duck session" between the beginning of November, when it was known that Roosevelt would be the next President, and March 1933 when he would take office was a peculiarly stultifying time. The difficulties of the situation called for firm leadership and resolute action, but the outgoing President felt unable to commit his successor and the President-elect had no power to act. The banking structure of the

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of the Chaco War between Bolivia and Paraguay in 1932 and the accession of de Valera to the Prime Ministership of the Irish Free State on 9 February 1933.

United States has always had the inherent weakness of a system of unit banks, for branch banking was largely prohibited. The assets of many of these unit banks were not in a sufficiently liquid position to meet their liabilities and bank failures became epidemic. Furthermore, an appeal from a bank to the Reconstruction Finance Corporation for help was taken as a sign of weakness; a run on the bank might follow, and so banks feared to seek this aid. The strain grew rapidly more acute and in February 1933 Michigan had to declare a banking moratorium. Other States followed in quick succession, and the first official act of the new President was, on 6 March, to declare a national emergency and suspend for a week all banking operations throughout the nation. Three days later, the Emergency Banking Act was passed which gave the President power to nationalise gold and to control banking, the foreign exchange, and gold exports. This, in effect, took the United States off the gold standard and by the middle of July the dollar was at a 30% discount. On 12 May the Government had committed themselves, through the Thomas amendment to the Agricultural Adjustment Act, to a policy of inflation. The motive was to stem the recession and return to prosperity by engineering a rise in prices through the outpouring of a maximum of 3,000 million dollars of new money or, if that proved unavailing, by reducing the gold content of the dollar.

In June 1933 the World Economic Conference assembled in London. The Geneva Economic

Conference had met in 1927 in order to maintain and consolidate prosperity; the London Conference met at the depth of the world depression in order to rescue civilisation.

CHAPTER VIII

THE SECOND DEVALUATIONS, 1931–36

THE somewhat discursive account, given in the last chapter, of the events of the first few years following the Wall Street crash, must not obscure the fact that, behind all these events, there was the fundamental necessity of a currency adjustment to the lower level of prices. As prices fell, all the usual economic maladjustments caused by the upsetting of the creditor-debtor relations occurred, and, with the real burden of debt increasing and the revenue from taxation falling as business declined, Governments were at once in financial difficulties. Business would not recover until prices rose or costs fell and, as it is less politically difficult to hoist prices through currency depreciation than to beat down wages, the world entered on a second period of currency adjustment. This second period, however, had some marked differences from the first period, described in Chapter V. In the first devaluations we saw (1) that some countries, after a period of hyper-inflation, started a new currency on a gold basis; (2) other countries managed to steady the fall in the value of their currency unit and then devalued, either keeping the old name, as in the case of the French franc, or adopting a new one;

(3) a few countries fought their way back to gold by a deflationary price policy. The result was that the world by 1928 was back on the gold standard. In this second period of currency adjustment, however, firstly, there was no case of hyper-inflation; secondly, there was no case of a *return* to gold by a drastic deflationary price policy; and, thirdly, when the strain became too great, the usual plan followed was to allow the currency to depreciate, but when it was possible to steady the fall, the return to gold was not made: the currency merely floated at its own level without any anchorage. This was not universally true; as we shall see, Belgium and the United States did definitely devalue. A fourth distinction of this second period was the growth of controlled exchanges, Governments making their currencies available only at official rates, higher than the uncontrolled rate would have been. When it was a matter of foreigners buying the overvalued currency, this merely resulted in a decline in tourist traffic and in exports, and to avoid such results special rates were sometimes given to tourists and subsidies to exporters. When it was a matter of natives selling the overvalued currency, there were no buyers at the rate and consequently the flight of capital was prevented. The hindrance to trade of controlled exchanges was so serious that eventually a considerable number of clearing arrangements developed.

A last distinction of the period was the setting up of Exchange Equalisation Funds providing a method of obviating undue fluctuations in the cur-

rency or, in the words of the League of Nations *World Economic Survey*, "a more flexible use of a secondary gold reserve designed to absorb exchange fluctuations caused by violent short-term capital movements, without the necessity for interfering with domestic credit conditions by using the discount rate".[1]

The first abandonments of the gold standard were in South America and Canada. Why this was so may have been that, although Europe was almost equally hit by the cessation of American lending and the fall in prices, the first blow was lightened by some loans by France to her political allies, the second because prices fell more rapidly in the agricultural countries. The Argentine and Uruguay suspended gold payment in December 1929; Canada, in the same month, introduced restrictions on gold export, though her case was peculiar, being chiefly the result of the hold-up of the export of the wheat crop by the newly-formed Wheat Pools. She was back on the gold standard again by June 1930. In 1930 the exchanges of Brazil, Chile, Venezuela, Paraguay, Peru, Australia and New Zealand fell and remained below the gold export point. Mexico suspended the gold standard in July 1931. With the British suspension in September there came a rush of abandonment. Before the end of the year, Bolivia, Denmark, Canada, Egypt, India, Norway, Palestine, Sweden, Finland, Portugal, San Salvador, Colombia and Japan had followed Britain's lead. A few countries, notably South Africa, left in 1932, and then came

[1] Op. cit., 1935–36, p. 271.

the abandonment by the United States in April 1933, followed by a further fall in South American currencies.

By the middle of 1933 the world had split into four currency groups: (*a*) the sterling bloc; (*b*) the United States and its satellites; (*c*) the gold bloc, sub-divided into those countries, like France, on a genuine gold standard, and those maintaining a nominal standard by exchange control; (*d*) Canada, whose dollar tended to keep a position intermediate between those of the first two groups.

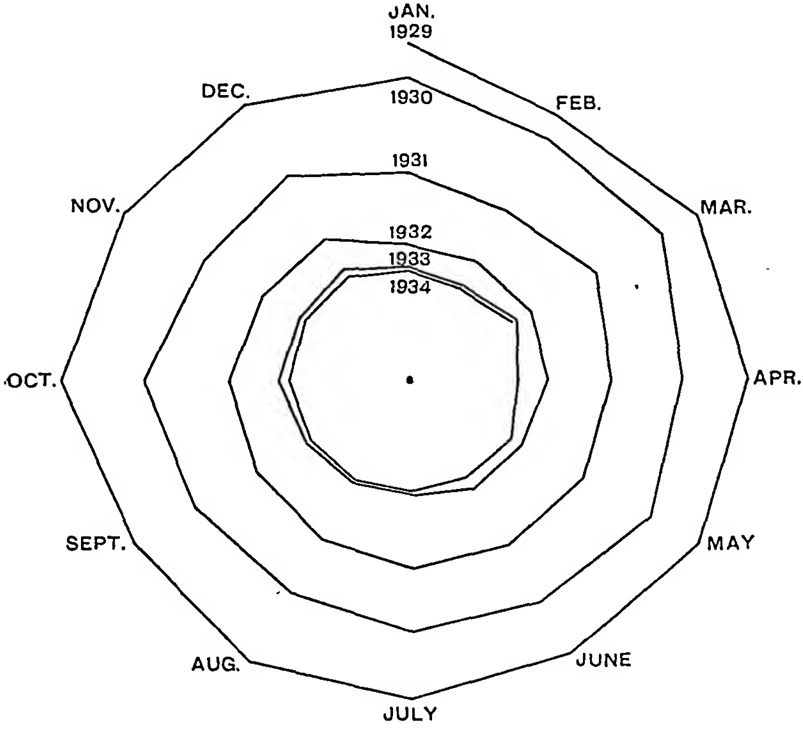
On 31 October 1932 when economic chaos was developing to an extent that almost threatened the continuance of civilised life, a Preparatory Commission met at Geneva to prepare for a World Economic Conference. Some steps had already been taken to check the depression. The countries of the British Empire had signed an agreement at the Ottawa Conference in August which was intended to stimulate trade within the Empire. The British, finding it impossible to obtain tariff reductions generally, had hoped to be able to bring about a reduction of tariffs as between the Empire countries, but the actual result was mainly to leave the Empire tariffs at their existing levels and to raise the duties against non-Empire goods. This greater preference for Empire goods led to a diversion of trade rather than to an increase in its total volume. In September a Conference was held at Stresa for the economic restoration of Central and Eastern Europe which emphasised, in the words of the Chairman, "the deadly peril in which Europe stands if it

continues to multiply barriers, restrictions, prohibitions, and impediments of every kind to the freedom of trade" and the need for financial and currency reform. Both the Ottawa and the Stresa Conferences were to some extent overshadowed by the impending World Economic Conference which assembled in London on 12 June 1933 and was attended by delegates from 64 nations.

The main hope for the success of the Conference was that the extremities to which the forces of disintegration had already carried the economic and financial world were so appalling that the Conference could not afford to fail. The Preparatory Commission of Experts had thought it necessary, at the commencement of their report, to call attention to the gravity of the situation. "Unemployment," they wrote, "has recently been estimated as involving at least 30 million workers. Even this huge total, which does not include the workers' families or other dependants, is probably an underestimate. The burden of suffering and demoralisation resulting from unemployment of such proportions is appalling. Wholesale commodity prices—expressed in gold—have declined since October 1929 by roughly a third; raw material prices on the average by 50 to 60%. In the middle of December, at Winnipeg, the price of wheat fell to the lowest level recorded in any primary market for wheat during the past four centuries. Such price-declines have produced profound disturbances in the economic system. They have thrown completely out of adjustment prevailing costs of the various factors

of production, have made business enterprise generally unremunerative, and have seriously disorganised practically all the world markets. World stocks of agricultural products and of other raw materials continue to accumulate. The index of world stocks for 1932 was double that for 1925. Huge accumulations thus overhang some of the principal markets and burden the processes of orderly price readjustment. Industrial production has been drastically curtailed, particularly in those trades producing capital equipment. The depths which have been reached in some instances are illustrated by the position of the United States steel industry which, at the close of 1932, was operating at only 10% of capacity. The international flow of goods, hindered by currency disorders and restricted by a multiplicity of new governmental interventions, has been reduced to incredibly low levels. The total value of world trade in the third quarter of 1932 was only about one-third of that in the corresponding period of 1929. The fall during the three-year period was continuous. Moreover, the quantum of goods in foreign trade appears to have fallen by at least 25%; by fai the largest fall on record. As a result of price-declines and the fall in the volume of production and trade, national incomes in many countries have fallen, it is estimated, by more than 40%. The revenues of Governments, as a consequence, have suffered sharp reductions, while expenditures have shown no corresponding decline. The inevitable result has been a series of budget deficits which, in some cases, have reached

unprecedented proportions. Only a handful of countries now retain free and uncontrolled gold-standard currency systems. Almost half the countries of the world are off the gold standard and, in some



THE CONTRACTING SPIRAL OF WORLD TRADE in Gold Value

Adapted from the League of Nations World Economic Survey, 1932–33.

forty countries, exchange restrictions have been imposed."[1] There was, they added, a state of virtual economic warfare and the necessary programme, in essence, was one of economic disarma-

[1] League of Nations, *Draft annotated agenda submitted by the Preparatory Commission of Experts*, pp. 5, 6.

ment. "Failure in this critical undertaking threatens a world-wide adoption of ideals of national self-sufficiency which cut unmistakably athwart the lines of economic development. Such a choice would shake the whole system of international finance to its foundations, standards of living would be lowered and the social system as we know it could hardly survive."

The same note of serious warning was struck by Ramsay MacDonald, the President of the Conference, in his opening address: "There is indeed a volume of human need and human anguish which I must beg every delegate, every expert, and every critic of our Conference to bear constantly in mind. Thirty millions, at least, of our fellow men are unemployed throughout the world. Is not the memory of this terrible accumulation of undeserved poverty and depressing idleness with all the social evils that they bring in their train, a sufficient incentive to us to strive for success? Is there any Government who will refuse, as part of a co-operative international effort, to modify its present fiscal and monetary policy, if by so doing there is reason to hope that this misery will be reduced?"

It is amazing that, in spite of these very serious and thoroughly justified warnings, the London Conference was a complete fiasco. The growing economic distress was clearly leading to increased political tension, which reacted on business confidence and increased the distress. By this sort of vicious spiral the world was going into a tailspin that would, unless corrected, end in a complete

crash. What was needed to ease the political tension was a return of economic prosperity, and that could only be brought about by freer trade and stabilised currencies. The London Conference, therefore, had manifestly to aim at obtaining these two objectives. Negotiations, however, about reducing tariffs and other obstacles to trade were meaningless so long as any concessions of lower duties or other advantages could be nullified by currency depreciation. It seemed that, if any progress at all was to be made, the pinning-down of money to some definite value had to be the first step. Such a stabilisation might, and under the existing circumstances could, only be a temporary expedient, but, on the basis of an agreed temporary stabilisation, something might be accomplished towards the destruction of trade barriers. Doubtless, when the revival of international trade had checked the depression and economic recovery had set in, there would have to be some later reconsideration of the validity of the new stabilised levels, but the really important point was that, without some temporary fixation of the value of currencies, no trade agreements could have any meaning, significance, or utility, and nothing could be done. The Conference met, accordingly, with the clearly understood necessity of tackling the stabilisation problem first. It met at an unfortunate time. The United States had just embarked on their policy of inflation; the dollar was depreciating; and the Government of that country became averse to any provisional stabilisation of its currency which

would prevent the working out of the new policy. On 5 July the President of the United States wrote bluntly that he was against any attempt at achieving a temporary stability. Such an attempt being impossible without the co-operation of the United States, and no other progress being possible without temporary stabilisation, the Conference at once dramatically collapsed. This collapse can certainly be added to our list[1] of major post-war economic catastrophes. The world, of course, needed price reflation; it was necessary to have rising prices as the only method, other than default, of dealing with the impossibly oppressive debt structure, and as the only method, other than wage and cost reduction, of reasonably quickly restoring the profitability of business. If President Roosevelt was right in refusing to stop his policy of raising prices in the United States, he was wrong in declining to consider temporary stabilisation. If the French were correct in urging temporary stabilisation, they were wrong in pressing a stabilisation of prices at the existing gold levels. What was wanted was a degree of temporary stabilisation which would have permitted a controlled rise in the world price-level, and this, though difficult, might have been possible had the French and the Americans shown that willingness to modify their fiscal and monetary policies for which Ramsay MacDonald had pleaded.

Immediately after the complete collapse of the London Conference came the formal avowal of the

[1] See p. 86.

gold and sterling blocs. Six gold standard countries, headed by France, announced their agreement in a policy of maintaining their currencies at the existing gold parity rates. The British Empire countries declared the policy of the sterling bloc to be one that aimed at such a rise in prices as would restore economic equilibrium as between costs and prices, and between debts and economic capacity to pay.

The United States continued with their inflationary policy. Anticipating rising prices, the American consumer bought; in response to this demand and expecting rising costs, the American producer increased production. The summer of 1933 experienced a revival in business activity and in the Stock market, but when the consumers, having bought ahead of their current needs, reduced their demand, and producers, having stocked up ahead of demand, sat back, the temporary revival collapsed. In spite of this example of how awkwardly the anticipation of price inflation could work, the Government continued in its efforts to get prices higher by depreciating the currency. It is, of course, obvious that a higher price in a proportionately depreciated currency is itself no advantage to the producer. The possible defence of the policy lay in its tendency to restore a better balance between prices and costs, since wages were not likely to rise as quickly as prices, and in its restoration of the creditor-debtor relationship whose upset had been causing not merely bankruptcies but maladjustments in the supply of particular products to a shift in effective demand. With the aid thus

brought to economic adjustment, the depression, it was hoped, might be checked and, with a revived possibility of profitable enterprise, recovery might come through the cumulative process of increased employment, production, and purchasing power. The idea was popularised as a "priming the pump" policy, and the popular conception was that the Government poured out money to increase purchasing power which would restore business confidence, and private enterprise would then revive and take over the economic activities of the nation. Everything depended on a timely revival of business confidence, and to this we shall recur later.

The recession after the summer revival led to the necessity of further action and the United States entered upon their eccentric gold-purchasing policy. Gold had been nationalised and the gold mining industry in the United States had lost its home market. The Government decided in October 1933 to buy all the future output of the home mines, but they seem to have considered that, by paying higher and higher prices for gold, the dollar would depreciate, and commodity prices generally rise, more quickly. Starting with a price \$1·56 an ounce above the market price, they raised their buying price repeatedly until it reached \$34·45 a fine ounce by the middle of January 1934. All this time the fluctuations of the dollar on the exchange had been detrimental to trade, so Congress passed the Gold Reserve Act on 30 January 1934, ordering the President to devalue to at least 60%

of the former gold content, and on the following day the United States dollar was definitely devalued to 59·06% of its former parity, which gave an equivalent of $35 per fine ounce. Since the Treasury were prepared to buy, or sell for export, at that rate, this put the United States back on a gold bullion standard.

The $35 rate made, and was intended to make, the dollar cheap for foreigners. Why was this done? The inflationary policy of the Roosevelt Government in pouring out money had not resulted in raising prices sufficiently,[1] because American citizens were afraid to use the money either to buy commodities or to invest in productive enterprises; generally speaking, the additional money merely accumulated in the banks. Hence it was thought that if their own people would not use the dollars to buy goods, the foreigner might. But he had to have the dollars first. The sensible plan would have been to have bought his goods, through a lowering of the tariff, and thus give him the dollars in exchange. This, however, ran up against a protectionist psychology and as an alternative it was decided to buy his gold. He would then get dollars and with them buy American products; the American exporters would have more money to spend and would buy more home products, and hence the prices both of export and domestic goods would tend to rise.

The result of the offer of $35 for an ounce of

[1] The index number for wholesale prices had stuck at 71 during the last four months of 1933.

gold was an immediate rush of gold, estimated at 700 million dollars, into the United States Treasury from all countries where it was obtainable, a drain which eventually broke up the gold bloc and caused the abandonment of the gold standard.

A similar policy, peculiarly inept in conception, was followed with regard to silver. A Silver Purchase Act was passed in June 1934 and silver was nationalised in August. The price of silver, which had been 43 cents an ounce when the President opened the mint to the coinage of domestic silver in December 1933, was pushed up to 81 cents by April 1935, with the result that China, who for generations had never had to face falling commodity prices, was forced, after unavailing protests, to abandon her silver standard and reconstruct her currency on a different basis. The exports of large quantities of silver from China and some other countries were more than the United States were prepared to absorb and the market price for silver has since fallen below the 1933 level from which the buying policy started. It is strange to find that this silver purchase policy was originally defended as a method of stabilising the price of silver and of helping China.

It has to be remembered that these experimental monetary policies in the United States were being carried on at the same time as the Government's economic policies were being developed. These latter are conveniently summarised as the New Deal, but it is impossible to give here an adequate summary of all the very numerous, and often

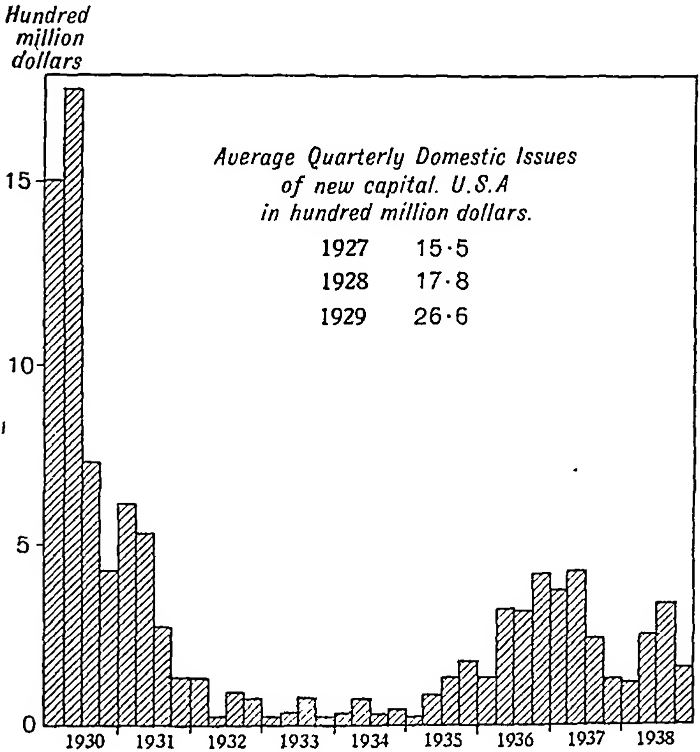
lengthy and involved, Acts of Congress and the powers and duties of the even more numerous administrative bodies created to enforce them. There were efforts to correct the distorted relations between agriculture and industry; efforts, in the National Industrial Reconstruction Act, to favour the extension of rationalisation in industry and to reform industrial conditions by the institution of codes; Government entrance into the public utility field; efforts at social reform in the various labour Acts and in the Social Security Act; attacks on the alleged malpractices of big business and the Stock Exchange. The net effect of all this legislation, some of it contested in the Supreme Court and found *ultra vires*, together with the doubtful monetary policies and the rapidly growing public debt, was thoroughly to discourage and bewilder private enterprise. Ever more money had to go to prime the pump, but the money merely found its way into the sump of excess bank reserves. The passage, over the Presidential veto, of the Veterans' Bonus Bill in January 1936 was significant of the lengths to which Congress was prepared to go.[1]

While these developments were taking place in the United States, the sterling bloc countries, under the leadership of Great Britain, were, after the collapse of the London Conference, following their policy of easy money and what might be called a carefully controlled inflation. Commodity prices were kept very steady in the United Kingdom for

[1] This Act gave some 3½ million war veterans nearly 2,500 million dollars' worth of bonds which could be cashed on demand.

the four years 1932–35, so that the people never lost confidence in their money, and sterling became again the most respected currency in the world. Panic money often fled to London, but its effect

CORPORATE ISSUES FOR NEW CAPITAL, U.S.A.

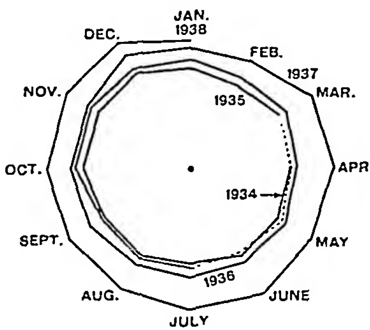


THE DECLINE IN BUSINESS CONFIDENCE
Quarterly Domestic Issues of New Capital, U.S.A.

was neutralised by the working of the Exchange Equalisation Fund. Though the commodity prices were steady in terms of British currency, the policy was inflationary in respect to gold values, for the

pound was worth 87 gold francs in January 1932 but less than 75 gold francs in January 1935. However, the change from a constantly falling price level under the gold standard to steady prices after the link with gold was severed, and the advantages of steady exchange with the countries of the sterling bloc, revived business confidence in the United Kingdom and economic conditions started steadily to improve. No great return of prosperity, however, could be expected so long as international trade was heavily fettered. The London Conference had opened with a tariff truce, but, on the failure of the Conference, the truce was quickly ended. Thenceforward progress was only made by the negotiations of bilateral treaties; for example, the United Kingdom successfully concluded a long series of trade treaties, and Germany made a number of clearing agreements. Bilateral concessions are better than no concessions at all, but the country in which is the best market to sell your goods is often not the best market in which to buy what you require. Much of the world's trade had been beneficially multilateral and the forcing of trade by bilateral treaties into unwonted channels often broke former trade connections and will make it all the more difficult to revive a world-wide trading system. No hatter is so mad as to refuse to buy enough bread for his family unless the baker will spend an equal sum on hats purchased from him, yet every country seems unwilling to buy from any other unless the trade is reciprocal.

Economic revival in the industrial countries had started in a slow and tentative way in 1932. Helped at first by the low price of raw materials, in some cases by reductions in wages made possible by the lower cost of living as prices fell, it gathered force, especially in the sterling-bloc countries, as commodity prices ceased falling, money rates were held low, and bilateral trade agreements opened here and there an outlet for trade. In 1935 the



THE EXPANDING SPIRAL OF
WORLD TRADE
in Gold Value
On the same scale as the diagram on page 118

gold value of world trade ceased to fall; the quantum had already risen.

The economic revival, however, was not experienced in the gold-bloc countries. Their currency being over-valued, foreigners would neither buy their goods nor visit their country to the same extent as formerly. Exports and the tourist traffic dwindled. The drain of their gold reserves to the United States also made it necessary for the gold-bloc countries to endeavour to raise the real value

of their money in their own countries so that it would no longer be profitable to change it, through gold at a fixed rate, into dollars. This endeavour involved higher money rates and falling commodity prices with all the discouragement to industry that these bring, especially when the end cannot be foreseen. The general level of prices was reduced in France during 1934 by 16%. The clash of the United States trying to hoist prices and the gold-bloc trying to bring them down could not go on indefinitely; the stress and strain set up by two diametrically opposed monetary policies had to break, and, until the break came, uncertainty added to the difficulties.

The gold-bloc put up a gallant, if perhaps a mistaken, fight. Czechoslovakia had already devalued in February 1934; on 1 April 1935 Belgium devalued the belga by 28%. When Poland instituted exchange control in April 1935, there were only three countries—France, the Netherlands, and Switzerland—of the gold-bloc remaining to continue the fight. The difficulties in France increased; there was in power a Popular Front Government which by measures of social reform was increasing the costs of production at the same time as the defence of the franc was rendering a deflationary price policy inevitable. It was impossible to go on. On 26 September 1936 the gold standard was suspended in France by decree; on the 27th the Netherlands placed an embargo on the export of gold unless authorised by the Netherlands Bank: on the 28th Switzerland stopped the redemption

of notes in gold and the Swiss National Bank was ordered to maintain the gold parity of the Swiss franc at a value ranging between 190 and 215 milligrammes of fine gold, corresponding to a mean devaluation of 30%. On 1 October France passed a new monetary law repealing the obligation of the Bank of France to buy and sell gold at a fixed price. The gold content of the franc was reduced from 65·5 milligrammes of gold $\frac{9}{10}$ fine to an amount not less than 43 or more than 49 milligrammes to be fixed by the French Government, which meant a devaluation of between 65·6 and 74·8%. The gold holdings of the Bank of France were revalued and 10,000 million francs set aside for an Exchange stabilisation fund.

The break-up of the gold-bloc was at once followed by monetary adjustments in other countries. Latvia devalued and, with Greece, joined the sterling-bloc. Italy devalued and, as Brazil, pegged its currency to the United States dollar. Czecho-slovakia devalued again and, as Russia, attempted to attach its currency to the new French franc. Turkey devalued.

These adjustments were regarded at the time as a possible end to the series of devaluations necessitated by the fall in world prices after 1929. "A notable step," said the League of Nations *World Economic Survey*,[1] "has been taken towards the consolidation of exchange stability and the re-organisation of an international monetary standard."

[1] Op. cit., 1936–37, p. 8.

CHAPTER IX

THE PRESENT POSITION

SINCE the first devaluations of 1924–28 cleared the ground for the quicker and less hampered working of economic adjustment and ushered in a period of very considerable prosperity, it might be supposed that the second devaluations would have been followed by a similar result. To a certain extent this was so. The level of manufacturing output in the world in 1937 was the highest ever recorded, and it, excluding the U.S.S.R., was estimated to have been more than 3% higher than in 1929.

1929=100	1932	1937
World index of primary production	92	110
World index of industrial production[1]	63·7	103·3
Quantum of world trade	74·5	96·9

The conditions, however, after the second devaluations were in some respects definitely less favourable to economic progress than were those after the first, and particularly so in three respects; in the currency situation, in the degree of political tension, and in the degree of confidence in the economic situation in the United States.

[1] Excluding the U.S.S.R.

The Currency Situation

The first devaluations re-established the gold standard in the world, with all that that meant in stable exchanges and assistance to international trade. The second devaluations have not restored the gold standard. Only one country, Belgium, of any commercial importance re-established a definitely fixed unprovisional new gold parity. The United States and Switzerland have fixed the price of gold but have specifically reserved the right to revoke or alter their arrangements for the unrestricted exchange of gold at twenty-four hours' notice. Great Britain has now revalued the gold holdings of the Bank of England, but her currency, as that of the Netherlands, is on an independent paper basis without any indication of its ultimate basis or the rates of interchange with other currencies. France has proved unable to sustain the value of the franc within the limits set by the devaluation of October 1936. The difficulties in France—caused by the rising costs of production, which accompanied higher wage rates and reduced hours of work, and by the Government borrowings, largely for rearmament, which caused prices to rise and imports to increase—created a nervous anxiety which led to flights of capital on a large scale. At the end of June 1937 the lower limit set by the October 1936 law, about 112 francs to the pound, was abandoned and the franc depreciated rapidly. The domestic and exchange difficulties continuing, a further attempt was made to set a basic limit to

depreciation and in May 1938 it was announced that the franc would not be allowed to depreciate beyond 179 francs to the pound. Many countries are still under a régime of strict exchange control.

It is true that, notwithstanding these conditions, a certain degree of exchange stability was achieved; several countries maintained their currency at a stable exchange rate with sterling, and the important dollar-sterling exchange rates had an annual percentage range of variation of only 4·1 in 1936 and 3·2 in 1937. The Tripartite Agreement of 25 September 1936 between Great Britain, France, and the United States, which Belgium, the Netherlands, and Switzerland subsequently joined, announced the intention of the signatories to maintain the greatest possible equilibrium in the system of international exchange and their agreement to make gold available for export to official agencies in the countries concerned at such rates and upon such conditions as might be deemed most advantageous to the public interest. This Agreement did something to restore confidence and was a welcome sign of increased willingness to co-operate. Moreover, the British Exchange Equalisation Fund, and the similar funds set up by several other countries, were able to play a useful part in preventing undue fluctuations in the currency exchange rates. Nevertheless, gold scares,[1] devaluation fears, and war scares, led to sharp fluctuations in exchange rates as fugitive money was hastily transferred from one centre to another; more than one Exchange

[1] See page 140.

Equalisation Fund become so nearly exhausted that it had to be replenished by additional Government-provided funds. Confidence in the stability of exchange rates was definitely less than it had been after the first devaluations when most people had supposed, and all had hoped, that the gold standard had returned for good.

Political Tension

The second great difference in the situation after the second devaluations, as contrasted with that after the first, is the much greater degree of tension in the political field. Contrast October 1926 with October 1938. In October 1926 there were no wars, faith in the League of Nations was still strong, and Germany had just joined the League. The Locarno Treaties had been signed in 1925 and the political tension was less, and the prospects of the amelioration of international relations brighter, than at any time since the years before the shadow of the Great War appeared. On the other hand, in October 1938 there were wars in China and in Spain, and a general outbreak of war all over Europe had only been prevented at the very last minute. The fear of such a conflagration remained. On the economic side, this fear had three results of particular importance. Firstly, the prevailing general uncertainty was very detrimental to all business, domestic and foreign, and was reflected both in the nervousness of the Stock Exchanges and in the recurring panic flights of capital. Secondly, the

endeavour to buttress economic security in case of war had been leading to an accelerated growth of economic nationalism with all the impediments that this threw up against international trade and all the economic waste it involved in the distortion of productive power to the manufacture of substitutes. In May 1937 Germany imposed a duty on imported rubber, nearly doubling its price inside that country, in order to foster the production of the synthetic rubber called buna. The incursion of Governments purchasing large amounts of food-stuffs or war materials to build up a reserve supply disorganized markets; thus, after the announcement of the British Government's rearmament programme, copper, which had been £47·75 a ton at the end of 1936, was rushed up to £73·75 by March 1937. Thirdly, the expenditures of Governments, both on rearmament and on other forms of preparedness, necessitated increased taxation or increased borrowing. In recent years the expenditure on armaments has risen from 3% to 7% of the national income in the United Kingdom and from 4·5% to 10% of the national income in France.[1] The internal debt of the German Reich has increased from under 2,000 million reichsmarks at the beginning of 1929 to over 14,000 million in the spring of 1938.[2] The total Government expenditure in Japan has risen from 1,476 million yen for the year 1931–32

[1] League of Nations, *World Economic Survey* 1937–38, p. 201. The expenditure has since risen to considerably greater proportions.

[2] *Eighth Annual Report of the Bank for International Settlements*, p. 93.

to an estimated 7,718 million yen for 1938–39. Increased taxation, besides discouraging enterprise, causes economic maladjustments through the shifting of effective demand from the tax-paying group to the recipients of Government expenditure. Increased borrowing threatens to bring inflation and rising prices, upsetting the creditor-debtor relationship and the foreign trade balance, and giving rise to industrial trouble as the cost of living goes up. Wholesale prices in the United Kingdom were 20% higher in the summer of 1937 than in the preceding summer, a pace which, had it been maintained, would have broken up the sterling bloc. In the early months of 1937 Sweden was already considering the advisability of departure.

The Business Atmosphere in the United States

The third striking contrast between the situation at the close of the first and second devaluations is the difference in the degrees of confidence in the economic future of the United States. The commercial importance of the United States is so great that prosperity or depression in that country has a very large influence on the economic fortunes of the rest of the world. The United States produce five-sixths of the world's motor vehicles and three-fifths of the petroleum, half the world's cotton, more than one-third of the pig-iron and nearly 40% of the steel, 30% of the world's coal, and over a quarter of the rayon. The United States consume

half the world's rubber output, half the tin, one-third of the copper, and rather less of the lead. In 1937 that country took 13·3% of the rest of the world's exports.

By the close of the first devaluations, the United States had entered on a period of wonderful and seemingly boundless prosperity; credit had expanded and production had increased enormously; the dollar, which had practically taken the place of gold as the world's standard of value, had a stability which the currencies of other countries were striving with difficulty to emulate. Optimism abounded. The people who were sanguinely discounting the future by instalment buying and speculation were applauded as having the courage of their convictions. To-day, the economic atmosphere is entirely different. The collapse after the Wall Street crash of 1929 gave a profound shock to the nation, and the sharp recession of 1937, after three years of strenuous efforts at recovery, has added to the uncertainty and gloom. Over 10 million workers were still wholly unemployed at the end of 1937 and unemployment was increasing. The dollar has lost much of its former prestige. Optimism has changed to anxiety.

The most fundamental causes for anxiety about the economic future in the United States were the gold position and the fiscal and economic policies of the Government. The monetary gold stock of the United States has risen from 8,000 million dollars' worth in 1934 to over 14,000 million dollars' worth at the end of 1938. Though the tremendous

influx of gold has at times been due to fugitive money seeking a secure haven, the main cause has been that the price of $35 an ounce, fixed by the Government in 1934, overvalues gold. It is difficult to believe that the United States will go on absorbing the world's gold; in essence the absorption means that the States are handing over goods, services, or securities, in exchange for the gold with which they can neither clothe nor feed their people. They can only bury it at Fort Knox. The gold serves no useful purpose; it does not give the people confidence in their paper dollars since gold is nationalised and cannot be obtained by the public. The real purpose of a gold reserve to-day is to enable a country to hold the foreign exchange value of its currency steady during a temporary adverse balance of indebtedness until the causes of the lack of balance have been corrected. Fourteen thousand millions is a wildly extravagant sum for that purpose. Hence the belief that the lack of adjustment between the purchasing power of the dollar and its gold value must be rectified sooner or later, and it can be rectified only in one of two ways; either the $35 price must be reduced to a lower figure, or the $35 must fall in purchasing power through a rise in prices in the States relative to prices in other countries.

Both methods of adjustment have their dangers. If the price of gold were reduced in the States below the present figure, it might, paradoxically enough, result at first in more gold, rather than less, going to that country, for there exists much

hoarded gold in the world to-day.[1] Some people have been keeping their liquid resources in the form of gold because they dared not trust any of the currencies. Obviously, if these people believed or knew that the price of gold—now held at $35 an ounce by the willingness of the United States to purchase any amount at that figure—was going to be reduced, they would throw their hoards on the market and, the size of the hoards being what it is, the American price might have to be considerably reduced before the next willing buyer to absorb such amounts was reached. Until he was, the gold would still flow to the States.

This sort of gold scare did come during the first half of 1937. Holders of gold had already found that when Governments nationalised and re-valued gold, the price they wanted to pay, and in some cases did pay, to the gold owner was not the revalued high price but the former low one. Gold began to look less safe as a store of value, but so long as the United States Treasury would pay $35 an ounce and gold export from other countries was allowed, the private hoarding of gold continued. At the end of 1936, however, there were indications that the United States Government were realising the futility of continually amassing gold. There was, furthermore, a vague feeling that the very large increase in the production of gold, which is twice as great as it was in 1929, ought inevitably

[1] In September 1936 the amount of privately hoarded gold, excluding the unreported reserves of Governments and central banks, was estimated at a value of between 1,500 and 2,000 million dollars, most of it held in London.

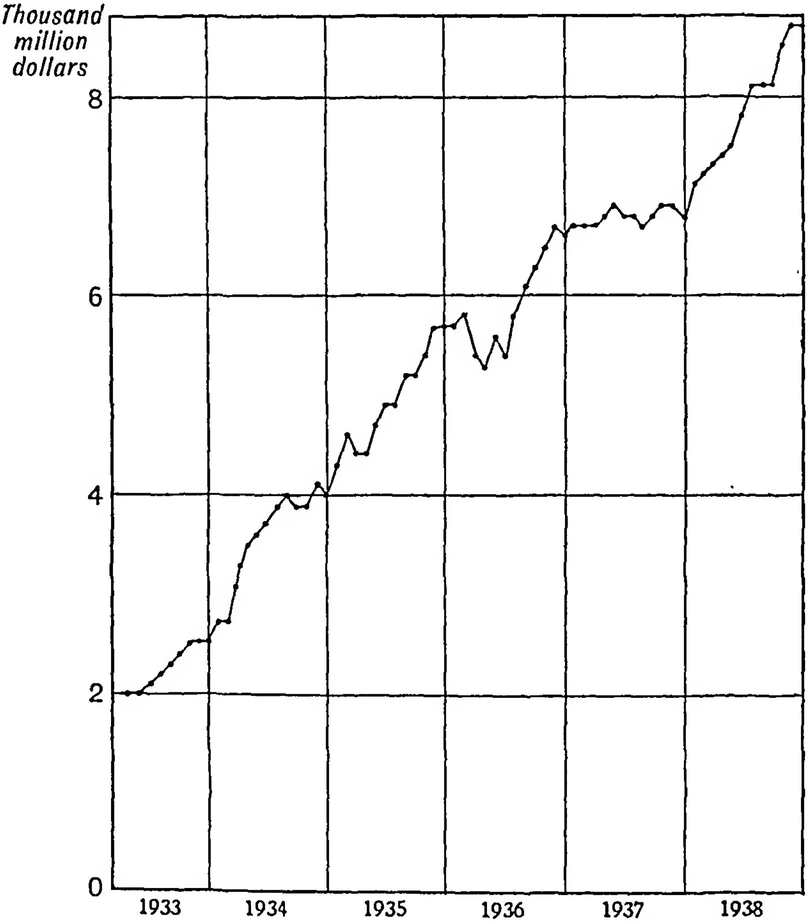
to make gold cheaper. The announcement by the United States Treasury in December 1936 that they were going to establish an "inactive account" for imported gold, in effect sterilising the gold and thus showing up its uselessness, coupled with the raising of the legal reserves which banks were required to keep, started a real gold scare. Holders of gold sold it for dollars and, if not content to hold the dollars, turned them into sterling or some other investment. During the scare about 1,000 million dollars' worth of gold was dehoarded, 60 million pounds' worth coming from the London market alone. Sterling rose from \$4·88 to \$5·04. There was a break in the value of gold-mining shares. The scare was checked by President Roosevelt's assurance in April that no reduction in the gold price was contemplated, and the willingness of the British Exchange Equalisation Fund to buy gold and an increase of £200,000,000 in its resources, granted in July.[1]

This episode of the gold scare of spring 1937 illustrates the difficulties that would occur if any rumour that the price of gold was to be lowered gained credence. Moreover, a reduction in the United States price, besides upsetting the exchange rates and causing further economic dislocations, would seriously affect all those Governments and central banks who have written up the value of their gold holdings.

If an ounce of gold is not really worth \$35 and if the dangers and difficulties of reducing the price are too great to face, the alternative is to render

[1] The Fund bought over 13 million ounces between the end of March and the end of September 1937.

the $35 less valuable by reducing its purchasing power through a rise of commodity prices in the United States. This alternative policy has the



THE GROWTH IN MEMBER BANKS RESERVES
U.S.A.

additional attraction that it, besides bringing the dollar and gold into equivalence, would also give an impetus to business and employment. In fact it has been the second consideration which has

been mainly responsible for the adoption of a commodity price-raising policy by the Roosevelt administration, a policy popularised as spending the way out of depression.[1] Prices were to be raised by the provision of more money through Government expenditure made possible by deficiency budgeting and Government borrowing, but, as has been mentioned,[2] the cumulative effect of the Government's new deal policies was to discourage private enterprise, so that the money thus provided largely silted up in the banks. The excess reserves of the member banks rapidly rose from under 1,000 million at the beginning of 1934 to over 3,000 million at the end of 1935, while their reserve balances (including both legally required and excess reserves) have risen practically continuously from under 3,000 million in January 1934 to over 9,000 million in January 1939.

It is this plethora of money which makes the policy of higher commodity prices so dangerous. The banks have the funds to support a gigantic credit and price inflation. If business confidence returns in full tide, the difficulties of stopping such an inflation, once it got well away, would be great. In fact, confidence was returning in the better world setting after the second devaluations and all through 1936. It was buttressed by the expenditure of the veterans' bonus and the Government outlays. Production, employment, and prices, were all moving upward. The rising prices brought an increase in the cost of living, and led, as always,

[1] See p. 122. [2] See p. 126.

to wage agitation and industrial trouble. There were over 2,500 strikes in the United States in 1937. The Standard Statistics Company's index of 419 common stock prices rose from 95 in December 1935 to 123 in December 1936. The pace accelerated. Another index number gives the 1936 average for 348 industrial common stocks as 127; by March 1937 it had risen to 153. In that month, therefore, the Chairman of the Board of Governors of the Federal Reserve System gave warning that the Government would have to intervene to stop the price inflation, and on 2 April the President stated that the prices of durable goods were too high and that Government expenditure would be shifted from that field. The expressed intention of the Government to check the rise in prices, an intention backed up by a reduction in Government expenditures, led to a collapse of the speculative position[1] and a general rapid recession in business. The lack of confidence was, doubtless, intensified by the effects of the gold scare and the growing political tension in Europe.

		March 1937	Date and lowest point of fall
1926=100	Wholesale Prices	87·8	May 1938 78·1
	Common Stocks	130	April 1938 71
Adjusted for seasonal variations 1923–25=100	Industrial Production	118	May 1938 76
	Factory Employment	101	June 1938 82

[1] The memories of the 1929 crash had made the American investor unusually nervous.

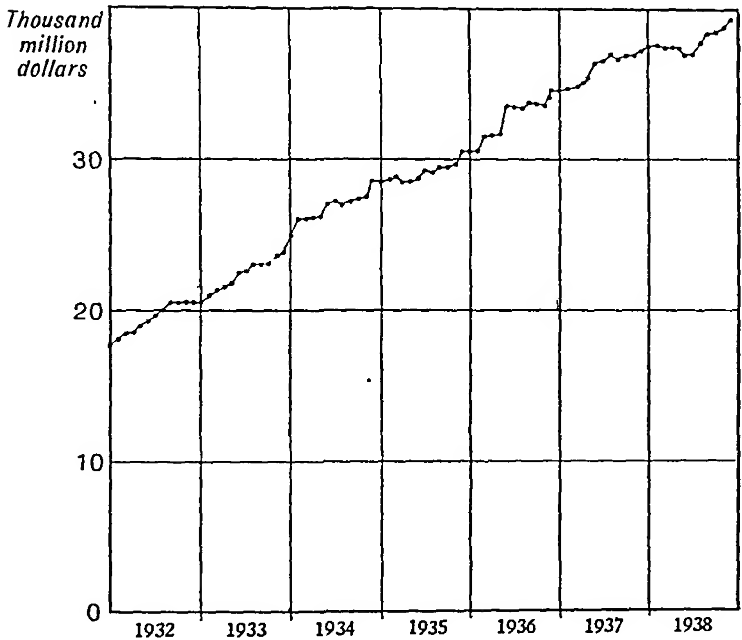
In face of this serious and rapid recession, the United States Government were called upon for action. There was, indeed, during the second half of 1937, a fear that the Government might be tempted to raise the dollar price of gold above the $35 an ounce, and a dollar scare developed. The rates of exchange moved against the dollar. Had private dealers been able to obtain American gold for export, the rates might have been maintained by an export of gold, but the Treasury gold is only sold to the official agencies of the countries adhering to the Tripartite Agreement. The refugee money fled to Europe. Switzerland and Sweden have been driven to discourage its entrance by reducing the rate of interest or by levying charges on foreign deposits held in their banks. It is true that this refugee money later fled back again as political tension and fear of war in Europe increased in the course of 1938.

The United States Government, however, did not raise the dollar price of gold. They reverted to their former inflationary monetary policy with a reaccelerated rate of borrowing and spending. In September 1937, 300 million dollars were released from the inactive fund; in February 1938 it was announced that only when the quarterly import of gold exceeded 100 million dollars would there be any further additions to the fund, and in April 1938 the fund was definitely abandoned and 1,392 million dollars desterilised. Meanwhile, from 1 October 1937 a new regulation of the Federal Reserve Board permitted the acceptance of any

paper—instead of the formerly specified categories—as collateral for rediscounts. From 1 November, margin requirements on advances for carrying stocks, which had been raised to check speculation, were reduced. Then, on 14 April 1938, came the President's announcement of the new Government spending: 2,062 million dollars to create employment, 950 million for relief, 1,500 million for the Reconstruction Finance Corporation. This expenditure, so long as it lasts, will have the same results as previous spates; there will be an increase in demand and a response from production, a rise in employment, a growth in speculation, and a rise in Stock Exchange quotations. But, when the money is spent, will not the result be the same as before; a collapse and recession, or a continuance of new spending, increasing Government debt and budget deficiencies? How long is it possible to carry on with budget deficiencies without impairing Government credit?

The general impression from a consideration of the Roosevelt administration in the monetary and economic field is that the car of economic progress is in the hands of an enthusiastic but inexpert driver; it either goes too furiously fast or it brakes too joltingly. The future will show whether the administration can become more expert in control or, failing that, whether it may not be better to hand the control back to the less personal and more automatic gear-changing forces of the market. Meantime there exists a lack of confidence in the economic future in the United States which has an

adverse effect on the whole world. As Professor Cassel wrote in January 1938[1] of the last recession: "Practically everybody is agreed that the menacing disturbance of the world economy emanates from the United States. It is also widely understood



THE GROWTH IN THE UNITED STATES GOVERNMENT DEBT

that the real disturbing factor is not any fundamental defect in the actual economic trend, but a lack of confidence, the absence of anything like a firm basis for judging future conditions for production, investment, and saving. This lack is

[1] *Skandinaviska Kreditaktiebolaget Quarterly Report*, No. 1, 1938, p. 1.

manifested most prominently in the monetary sphere."

. . . . .

A devaluation of money after a serious fall in prices is beneficial in restoring economic health. The fall in prices has shifted effective demand from group to group, e.g. from producers to the rentier class, has dislocated the relationship between costs and income, and has increased the real burden of debt. Whereas there would otherwise have to be a long and distressful period of economic adjustment to these changes, devaluation, by restoring conditions nearer to the old relationships, reduces both the length and the distress of the effort at adjustment. The whole economic conjuncture becomes more favourable to the process of atomic shifting of productive powers from the less to the more remunerative uses. This process, however, needs, if it is to make conspicuous headway, a period of quiet convalescence, free from further upsets and shocks. Furthermore, it needs a reasonable degree of freedom from restraint. To-day neither the requisite peacefulness nor freedom exist. Neither capital nor labour can move from country to country with anything like the former ease; the would-be emigrant cannot leave his home and the refugee cannot find a new one. Gold is imprisoned in Fort Knox and silver at West Point; the money of many countries is not allowed to cross the frontier. Business and trade everywhere is hampered and restricted by endless harassing regulations. Even within the national boundaries the mobility

of labour and capital is opposed by growing rigidities.

Economic stability and business confidence have been lost and must be restored before any considerable advance towards prosperity is possible. This book is an attempt at an introduction to post-war economic history and not an attempt at prophecy, but economic stability cannot return to a world of acute political tension. The first step necessary is the cessation of wars and threats of war, and the abatement of fears, suspicions, and grievances. So long as the world continues to prefer to have the guns before the butter, it is in reality choosing the gutter rather than buns, poverty rather than comfort. Not until there is political stability can there be economic stability, and not before economic stability can there be a restoration of an international standard of value, the lack of which bears so much responsibility for the hampering of human effort at supplying human needs.

. . . . .

One of the most fundamental economic problems before the world to-day is whether it is possible and advisable to return to the liberal organisation of economic life in which private enterprise stimulated by the profit motive and guided by the price mechanism was responsible for the establishment of economic equilibrium and the approach to the optimum use of productive resources. It was an organisation which demanded a considerable degree both of freedom from State interference at home

and of freedom in international trade and population movements. What such an organisation would be capable of achieving has been foreshadowed by the astonishing economic progress of the nineteenth century. If, however, the opinion is held that such a return is impossible, the alternative is to establish some sort of national brain trusts who would run the productive enterprises of each country and arrange for the distribution of the product. Even if such trustees would have the ability to undertake this colossal job, there is the difficulty of arranging for democratic control, too much of which would make for inefficiency and too little would result in tyranny.

The abuses and evils which creep into the liberal organisation of economic life have been experienced and are known; it need not be beyond the wit of man to rectify the one and abolish the other. The evils of the authoritarian State are only now becoming manifest by practical experience. The potentialities for economic welfare of the "capitalist system" should not be judged from the experience of the post-war years alone, when it was seriously handicapped by the war legacies of dislocation, debt, and distrust. It has been argued that the capitalist system was responsible for the War, but it certainly does not seem to be any less likely that the economic nationalism of authoritarian States may lead to war. War is the greatest evil; its prevention would appear to depend on the growth of a real spirit of internationalism which free trading is more likely to foster than autarky.

The economic justification of free enterprise is that millions of citizens all ardently searching for the best opportunities of using their resources most profitably are more likely to be successful in finding such than any handful of bureaucrats would be. Nor is it true to say that production need not be for profit. In any State, however organised, if the product of work does not yield an advantage, however measured, over the costs of production, it is futile to go on with the production. A social advantage may legitimately be weighed against a monetary loss, but the motive will still be to keep the loss as small as possible to obtain the advantages sought. Economy of effort must always be the guiding principle. For the estimation of the real strength of demand and the possibilities of supply, the almost impersonal forces of the market would appear to be more reliable guides than the decisions of State officials, decisions which must tend to become more and more arbitrary the further one goes from the consideration of a few standard necessities.

The social justification of free enterprise is that we all prefer freedom to direction. That too many of the workers to-day have little real freedom in the choice of employment may be unfortunately true, but it is doubtful whether they would welcome the loss of the little they have. Life would lose much of its savour if we all were told what we had to do and denied any option. Moreover, the extension of general education to all classes, which in most countries barely goes back two generations,

should in time widen the choice of employment and increase the opportunities.

However, when all has been said in favour of freedom of enterprise as a general principle, there remains one formidable problem: how can the free economy retain the advantages of the rationalisation of industry without incurring the abuse of economic power? It is on the possibility of solving that problem that the survival or revival of a free economy depends.

APPENDIX

"EXCLUDING THE U.S.S.R."

Economic developments in the Union of Soviet Socialist Republics—which it is still convenient to call Russia—have been in many ways insulated from those in the rest of the world. Their history can hardly be fitted into any outline of world economic history and is better treated separately. For example, there was a serious fall in the general level of world prices and of world production from 1929 to 1933, but reliable price statistics for Russia are not easy to obtain or interpret, and her production appears to have been increasing considerably during these years when the world level was falling. The Russian index number for the production of investment goods and consumption goods rose from 100 in 1929 to 234·8 and 164·8 respectively in 1933. To have incorporated such figures in the world figures would only have put the latter out of focus, and consequently many of the statistical series for the world are published with the appended note: "excluding the U.S.S.R." Again, consider the index number for the output of automobiles in Russia: it, based on 1929 as 100, rose from 39 in 1928 to 11,751 in 1937. Whatever that may signify,[1] it clearly has to be interpreted differently

[1] According to the *Statistical Year Book of the League of Nations*, the production of automobiles in the U.S.S.R. rose from 1,000 in 1928 to 200,000 in 1937.

from the figure for the United States, which fell from 100 in 1929 to 91·9 in 1937. All the peculiar circumstances of Russia have to be considered and the scale of the industry in 1928.

Although, for these reasons, the absence of much reference to Russia in the previous chapters may be justified, any introduction to world economic history since the War would be inadequate without some account of the very important and interesting developments of the Russian economy.

The post-war economic history of Russia may be conveniently divided into three periods: 1917–21, War Communism; 1921–28, the New Economic Policy; 1928 to date, the Planned Economy.

War Communism, 1917-21

The first period was mainly occupied by a desperate struggle to rescue the country from complete collapse. Even before the revolutions of 1917, the transport system had proved incapable of maintaining the supply of food at one and the same time to the armies at the front and to the civil population. In the early months of that year the food shortage in the cities became acute and it was the bread riots in Petrograd which formed the overture to the Kerensky revolution of February. The immediate sequel was the seizure of the land by the peasants and the establishment of soviets in the factories. There was a great decrease in production. The transport system was further disorganised by the dissolution of the army and its

spontaneous dispersal. In October the cost of living was five times as high as it had been in 1916. Discontent and disorder were rife and a second revolution put the Bolshevik party in power.

The new Government had a formidable task. They had to deal with armed enemies within and without. In March 1918 the treaty of peace with the Central Powers was signed at Brest-Litovsk; by the beginning of 1920 the counter-revolutionary armies led by Denikin and Kolchak had been crushed or dispersed. In that year, however, there was a short war with Poland and an insurrection in the Crimea led by Wrangel. It was under the distractions of the necessary efforts at defence that the Bolshevik party had to organise some form of government and attempt to reconstruct the economic life of the country. Their attempt mainly took the line of an extreme centralised control of production and a system of rationed distribution. The centralised control was at first, not unnaturally, marked by considerable inefficiency, inter-departmental friction, and bureaucratic cumbersomeness. It became necessary to requisition the agricultural produce of the peasants and to militarise the industrial workers. "Without a massive transference of workers, systematically organised by the State, according to the estimates of the economic organisations, we can," said Trotsky, "do nothing." Both measures led to serious discontent. At the same time financial necessity or deliberate policy[1] was annihilating the rouble.

[1] See page 62.

The New Economic Policy, 1921-28

By 1921 the abortive experiments in pure Communism were clearly bringing the country to disaster and on the 11th of August of that year Lenin announced the New Economic Policy. Money, intended to be of stable value, was reintroduced, and the right of private trading restored. The peasants, whose energy had been sapped by the requisition of their grain in return for worthless paper money, were encouraged to further efforts. Wages were paid with some regard to the value of the work performed. Under these changed conditions, production increased. The tacit recognition of private property provided so great a stimulus that private trading within two years had gained control over 90% of the re-established retail trade, and within three years over 30% of the wholesale trade. The Nepmen of the villages became the mainstay of the food supplies.[1]

The New Economic Policy was never intended to be the permanent policy; it was an unavoidable concession to the exigencies of the time, and the Soviet Government meant to continue the drive towards complete State Socialism, if not Communism, as soon as the economic conditions were recovered sufficiently to make further advance possible. The private trader was working for his own profit; the fundamental test of the possibility of Socialism is whether the worker will work as effectively when it is not for his own immediate

[1] *The Economist*, 1 Nov. 1930.

benefit but for what, he is told, is the common good. If the great social experiment was to be made, it was necessary firstly that private trading should be abolished at the first opportunity, and secondly that very great efforts should be made, by education, propaganda, emulation, threats, and penalties, to stimulate the energies of the workers in the socialised concerns.

A Planned Economy, 1928-

The third period, which can conveniently be dated from the formulation of the first Five-Year Plan in 1928, began with the liquidation of the new economic policy and the destruction of private ownership and operation in industry and commerce. In that year also there was a crisis in agriculture. After the revolution the land had passed into the occupation of the peasants and it is said that between 1917 and 1928 ten million new smallholders appeared. The consequent reduction in the size of the average holding meant that little grain was available in bad years except for the family on the farm. The harvest in 1928 was bad, and the grain collections were so low as to render strict rationing necessary. The decision was then taken to socialise agriculture, and the Kulaki, the class of more prosperous holders of the larger farms, were ruthlessly suppressed. Collective farms were established and an experiment was also made with some enormous State farms. By 1936, only 3·4% of the whole area sown was outside the collectivist or State farms.

If on the social side the main objective of the Bolshevik party was a classless society and on the political side a dictatorship of the proletariat, on the economic side it was a planned socialised domestic production and a State monopoly of foreign trade. The importance of foreign trade to Russia is no doubt considerable as a method of acquiring essential raw materials and means of production, but the volume of Russian foreign trade should not be exaggerated. In 1937 the exports of the U.S.S.R. were less than the exports of Denmark; the imports were less than those of Austria.

The five-years plan aimed particularly at a rapid industralisation, and the diversion of productive forces so largely into the supply of capital goods imposed considerable hardships on the people; hardships, however, which held the promise of future reward. It may not have been so much a genuine plan as an indicated goal of maximum expansion; targets erected by enthusiasts for the workers to shoot at. Certainly industry seems to have been for several years in a chronic state of reorganisation. If the plan went wrong, the blame was usually cast on some subordinate managers accused of wrecking or on the bureaucrats who were said to be dilatory and inefficient. The plan itself was not blamed and attention to its failure was quickly turned into the enthusiastic contemplation of another more glorious plan for the immediate future. As a matter of fact, the collection of all the data from the individual factories and workshops at the bottom, their collation into a

general plan, and the percolation of the plan back through the various channels to the bottom again was a long and complicated process. It is one of the crucial tests of the Russian experiment whether this bureaucratic method of centralised control and direction will more quickly and more effectively make supply adjustable to demand than does the price mechanism and profit motive in capitalist countries. Many examples might be given of the muddle and absurdities that resulted from the attempts to plan the whole economy of so large a territory, but the fact remains that the U.S.S.R. is still in existence and that the people are still being led or forced by the ruling power in the State towards the same objectives of a classless society and a centrally planned production.

The results of the first Five-Year Plan are summarised in a table given in the League of Nations World Economic Survey, 1933–34.

Product	Unit (millions)	1927–28	Production in 1932		
			Planned estimate		Actual result
			Original	Revised	
Coal	tons	35·4	75·0	90·0	64·2
Petroleum	tons	11·6	21·7	28·0	22·2
Cast-iron	tons	3·3	10·0	9·0	6·2
Steel	tons	4·0	10·4	9·5	5·9
Rolled steel	tons	3·2	8·0	6·7	4·2
Machinery	roubles	1822	4688	6800	7361
Cotton fabrics	metres	2695	4670	3061	2550
Boots and shoes	pairs	23	80	92	80
Electrical energy	kilowatt-hours	5050	17120	17000	13100

The real significance of this table is not that in some cases the plan was not fulfilled but that there did actually take place a very great increase in production. The machine production, in comparison with other countries, was still small. On the other hand, by 1935 Russia was second among the producing areas of the world for the amounts of pig-iron, gold, and petroleum produced, third in iron ore and steel, and fourth in coal. The production of gold had a special importance as providing a means of obtaining foreign exchange and thus easing the strain caused by the previous necessity to export goods in order to obtain the essential foreign machinery and equipment.

The second Five-Year Plan, started in 1933, while still demanding the expansion of the heavy industries, began to give more attention to the development of the lighter consumers' goods industries. An annual cumulative increase of 15% was planned for the heavy industries, 21% for the manufacture of food and 17% for other consumer industries.[1] As food supplies became less scanty, it was possible to abolish bread cards as from 1 January 1935. Meanwhile, the strenuous efforts at education and propaganda were beginning to bear fruit, and the industrial production per head of wage-earners increased by approximately 64% between 1932 and 1935. The second Five-Year Plan was announced as complete by 1 April 1937, nine months ahead of its programme.

An editorial writer in the *Economist* said in 1930:

[1] League of Nations, *World Economic Survey* 1934–35, p. 115.

"What Russia appears to be doing is to organise a national accumulation of capital on a gigantic scale at an extremely rapid rate; and this can only be done by deliberately depressing the level of domestic consumption, a policy which entails tremendous sacrifices to which the country is being stimulated by intensive propaganda supported in the last resort by methods of terrorism." Whatever one may think of this policy or of the degree of success it has attained, one thing is clear: the rapid and continuous expansion of Russian industrial production is one of the most remarkable and important of recent developments. The collectivisation of agriculture would seem to have been less successful. At its inception, there was a great slaughtering of live stock by the peasants, and since 1929 the production of foodstuffs per head appears not only to have fallen but also to have fallen more than in the rest of the world.[1]

[1] League of Nations, *World Economic Survey* 1937–38, p. 64.

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